Federal Taxes on Income and Profits

Guaranty Trust Company of New York

Federal Taxes on Income and Profits

Imposed by the Revenue Act of 1918

Guaranty Trust Company of New York

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Fifth Avenue and 43rd Street

MADISON AVENUE OFFICE
Madison Avenue and 60th Street

LONDON OFFICES
32 Lombard Street, E.C.
5 Lower Grosvenor Pl., S. W.

LIVERPOOL OFFICE
27 Cotton Exchange Buildings

PARIS OFFICE
1 & 3 Rue des Italiens

HAVRE OFFICE
122 Boulevard Strasbourg

BRUSSELS OFFICE
158 Rue Royale

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Foreword

THIS booklet contains a summary of important rulings of the Treasury Department relating to income and excess profits taxes, imposed under the Revenue Act of 1918. It has not been possible to cover all regulations which have been issued by the Department, but an effort has been made to cover those which are of the most general importance, laying special emphasis on those parts of the regulations which are applicable to the taxable year 1919. Much care has been used in the compilation of this booklet and although we cannot insure the accuracy of all statements, we believe them to be correct.

We have omitted reference to withholding of tax and information at the source, and the use of ownership certificates, these subjects having been treated in a separate booklet which we have prepared.

In the discussion of the excess profits tax, we have also omitted reference, so far as possible, to regulations dealing with the war profits tax, inasmuch as this tax is applicable only to corporations which report on the basis of a fiscal year in 1919, ending other than December 31, 1919, and to corporations which derive during 1919 more than $10,000 from Government contracts. As the majority of the corporations under the first class have already prepared their returns, and as the number of corporations deriving income from Government contracts, is comparatively few, we have not deemed it necessary to devote the amount of space which would be necessary to describe the computation of tax and the determination of income in such cases.

Guaranty Trust Company of New York

January 23, 1920

PART I. INCOME TAX—IMPOSITION OF TAX

RATES OF TAX

The statute imposes an income tax upon individuals, including a normal tax and a surtax. The tax is upon net income, after deducting from gross income, the allowable deductions.

Normal Tax.—For the calendar year 1919 and subsequent years the normal tax on individual citizens or residents of the United States is 4 per centum upon the first $4,000 in excess of allowable deductions and credits and 8 per centum upon the excess over that amount. The lower rate on the first $4,000 applies to each separate individual, whether married or unmarried, and should not be confused with the joint exemption granted married persons.

In the case of a nonresident alien individual the entire net income from sources within the United States, less any allowable deductions and credits, is subject to the normal tax at the rate of 8 per centum for 1919 and subsequent years.

Surtax.—In addition to the normal tax, a surtax is imposed upon the net income of every individual, resident or nonresident, in excess of $5,000. In determining the taxable net income for the purpose of the surtax the credits provided by Section 216 of the statute are not applicable.

The chart on page 2 shows the rates of normal tax and surtax and the total tax on citizens and residents of the United States on net incomes of specified amounts. The surtax for any amount of net income not shown in the chart is computed by adding to the total surtax for the largest amount shown which is less than the income, the surtax upon the excess over that amount at the rate indicated in the table.

Surtax on Sale of Mineral Deposits.—Where the taxpayer by prospecting and locating claims, or by exploring and discovering undeveloped claims, has demonstrated the principal value of mines, oil or gas wells, which prior to his efforts had a merely nominal value, the portion of the surtax attributable to a

INCOME TAX CHART

Based on the Revenue Act of 1918

(Chart shows the tax payable for 1919 and subsequent years by a married person, but does not take cognizance of the $200 exemption for each dependent child)

**Net Income	Rate of Normal Tax	Rate of Surtax	Amount Subject to Surtax Between Change of Rates	Amt. of Normal Tax	Amt. of Surtax on Instal.	Total* Surtax	Total Tax
$ 3,000	4%			40			40
4,000	4%			80			80
5,000	4%			120			120
6,000	4%	1%	5,000 to 6,000	160	10	10	170
8,000	8%	2%	6,000 to 8,000	320	40	50	370
10,000	8%	3%	8,000 to 10,000	480	60	110	590
12,000	8%	4%	10,000 to 12,000	640	80	190	830
14,000	8%	5%	12,000 to 14,000	800	100	290	1,090
16,000	8%	6%	14,000 to 16,000	960	120	410	1,370
18,000	8%	7%	16,000 to 18,000	1,120	140	550	1,670
20,000	8%	8%	18,000 to 20,000	1,280	160	710	1,990
22,000	8%	9%	20,000 to 22,000	1,440	180	890	2,330
24,000	8%	10%	22,000 to 24,000	1,600	200	1,090	2,690
26,000	8%	11%	24,000 to 26,000	1,760	220	1,310	3,070
28,000	8%	12%	26,000 to 28,000	1,920	240	1,550	3,470
30,000	8%	13%	28,000 to 30,000	2,080	260	1,810	3,890
32,000	8%	14%	30,000 to 32,000	2,240	280	2,090	4,330
34,000	8%	15%	32,000 to 34,000	2,400	300	2,390	4,790
36,000	8%	16%	34,000 to 36,000	2,560	320	2,710	5,270
38,000	8%	17%	36,000 to 38,000	2,720	340	3,050	5,770
40,000	8%	18%	38,000 to 40,000	2,880	360	3,410	6,290
42,000	8%	19%	40,000 to 42,000	3,040	380	3,790	6,830
44,000	8%	20%	42,000 to 44,000	3,200	400	4,190	7,390
46,000	8%	21%	44,000 to 46,000	3,360	420	4,610	7,970
48,000	8%	22%	46,000 to 48,000	3,520	440	5,050	8,570
50,000	8%	23%	48,000 to 50,000	3,680	460	5,510	9,190
52,000	8%	24%	50,000 to 52,000	3,840	480	5,990	9,830
54,000	8%	25%	52,000 to 54,000	4,000	500	6,490	10,490
56,000	8%	26%	54,000 to 56,000	4,160	520	7,010	11,170
58,000	8%	27%	56,000 to 58,000	4,320	540	7,550	11,870
60,000	8%	28%	58,000 to 60,000	4,480	560	8,110	12,590
62,000	8%	29%	60,000 to 62,000	4,640	580	8,690	13,330
64,000	8%	30%	62,000 to 64,000	4,800	600	9,290	14,090
66,000	8%	31%	64,000 to 66,000	4,960	620	9,910	14,870
68,000	8%	32%	66,000 to 68,000	5,120	640	10,550	15,670
70,000	8%	33%	68,000 to 70,000	5,280	660	11,210	16,490
72,000	8%	34%	70,000 to 72,000	5,440	680	11,890	17,330
74,000	8%	35%	72,000 to 74,000	5,600	700	12,590	18,190
76,000	8%	36%	74,000 to 76,000	5,760	720	13,310	19,070
78,000	8%	37%	76,000 to 78,000	5,920	740	14,050	19,970
80,000	8%	38%	78,000 to 80,000	6,080	760	14,810	20,890
82,000	8%	39%	80,000 to 82,000	6,240	780	15,590	21,830
84,000	8%	40%	82,000 to 84,000	6,400	800	16,390	22,790
86,000	8%	41%	84,000 to 86,000	6,560	820	17,210	23,770
88,000	8%	42%	86,000 to 88,000	6,720	840	18,050	24,770
90,000	8%	43%	88,000 to 90,000	6,880	860	18,910	25,790
92,000	8%	44%	90,000 to 92,000	7,040	880	19,790	26,830
94,000	8%	45%	92,000 to 94,000	7,200	900	20,690	27,890
96,000	8%	46%	94,000 to 96,000	7,360	920	21,610	28,970
98,000	8%	47%	96,000 to 98,000	7,520	940	22,550	30,070
100,000	8%	48%	98,000 to 100,000	7,680	960	23,510	31,190
150,000	8%	52%	100,000 to 150,000	11,680	26,000	49,510	61,190
200,000	8%	56%	150,000 to 200,000	15,680	28,000	77,510	93,190
300,000	8%	60%	200,000 to 300,000	23,680	60,000	137,510	161,190
500,000	8%	63%	300,000 to 500,000	39,680	126,000	263,510	303,190
1,000,000	8%	64%	500,000 to 1,000,000	79,680	320,000	583,510	663,190
over 1,000,000	8%	65%					

* Total Surtax is the total of the installments for the income considered.

** Exemption $2,000. No allowance is made for credit for dividends or interest on Liberty Bonds, if any, included in net income.

sale of such property or of the taxpayer's interest therein shall not exceed 20 per centum of the selling price. Exploration work alone without discovery is not sufficient to bring a case within this provision. Shares of stock in a corporation owning mines, oil or gas wells do not constitute an interest in such property. To determine the application of this provision to a particular case, the taxpayer should first compute the surtax in the ordinary way upon his net income, including his net income from any such sale. The proportion of the surtax indicated by the ratio which the taxpayer's net income from the sale of the property bears to his total net income is the portion of the surtax attributable to such sale, and if it exceeds 20 per centum of the selling price such portion of the surtax shall be reduced to that amount.

Profits of Corporations Taxable to Stockholders.—Section 220 of the statute provides that when a domestic or foreign corporation permits its profits to accumulate for the purpose of preventing the imposition of the surtax upon such income if distributed to its stockholders, it shall not be subject to the income tax as a corporation, but its stockholders shall be subject to tax in the same manner as the stockholders of a personal service corporation, except that the war profits and excess profits taxes of the corporation shall first be deducted from its net income before computing the proportionate shares of the stockholders. If, upon the basis of a statement of profits submitted on request of the Commissioner or a collector, the Commissioner certifies that in his opinion the accumulation is unreasonable, the corporation and its stockholders shall make their returns accordingly.

An accumulation of gains and profits is unreasonable if it is not required for the purpose of the business, considering all the circumstances of the case. No attempt can be made to enumerate all the ways in which gains and profits of a corporation may be accumulated for the reasonable needs of the business.

Undistributed income is considered to be properly accumulated if invested in increased inventories or additions to plant reasonably needed by the business. It is properly accumulated if retained for working capital required by the business or in accordance with contract obligations placed to the credit of a sinking fund for the purpose of retiring bonds issued by the corporation. In the case of a banking institution, the business of which is to receive and loan money, using capital, surplus and deposits for that purpose, undistributed income actually represented by loans or reasonably

retained for future loans is not accumulated beyond the reasonable needs of the business. The nature of the investments of gains and profits is immaterial, if they are not in fact needed in the business. Thus, the fact that an unreasonable accumulation of profits is invested by the corporation in obligations of the United States does not remove such corporation from the provisions of Section 220.

Persons Liable to Tax.—Every citizen of the United States, wherever resident, is liable to the tax, even though he may have no assets within the United States and receives no income from sources therein. Every resident alien individual is liable to the tax, even though his income is wholly from sources outside the United States. Every nonresident alien individual is liable to the tax on his income from sources within the United States. Estates and trusts are also subject to the tax.*

Citizen Defined.—Every person born in the United States subject to its jurisdiction, or naturalized in the United States, is a citizen. When any naturalized citizen has left the United States and resided for two years in the foreign country from which he came, or for five years in any other foreign country, he is presumed to have lost his American citizenship; but this presumption does not apply to residence abroad while the United States is at war.

Nonresident Alien Individual Defined.—"Nonresident alien individual" means an individual other than a citizen of the United States whose residence is not within the United States. Any alien living in the United States who is not a mere transient, and has no definite intention with regard to his stay, is a resident for purposes of the income tax. The best evidence of his intention is afforded by the conduct, acts, and declarations of the alien. A mere floating intention, indefinite as to time, to return to another country is not sufficient to constitute him a transient. The fact that an alien's family is abroad does not necessarily indicate that he is a transient rather than a resident. An alien who enters this country intending to make his home in a foreign country as soon as he has accumulated a sum of money sufficient to provide for his journey abroad is to be considered a transient, provided his expectation in this regard may reasonably be fulfilled within a comparatively short time, considering the rate of his savings.

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*See page 25.

Income Tax on Corporations.—An income tax is imposed upon the net income, after deducting credits, of all corporations, not expressly exempt under Section 231 of the law, at the rate of 10 per centum for the calendar year 1919 and subsequent years. The tax is imposed notwithstanding the fact that a domestic corporation has received no income from sources within the United States. On the other hand, a foreign corporation is taxed only on its net income from sources within the United States. Personal service corporations within the meaning of Section 200 of the law are not subject to taxation, but the individual stockholders thereof are taxed in the same manner as the members of partnerships and all the provisions of the law relating to partnerships and the members thereof, as far as practicable, apply to personal service corporations and the stockholders thereof. For definition of a personal service corporation, see page 22.

CREDITS

Individuals

For the purpose of imposing the normal tax, net income, as determined by deducting from gross income the allowable deductions, is first reduced by the sum of the allowable credits. These include:

(1) Dividends received from a corporation taxable upon its net income, or dividends from a personal service corporation paid out of earnings upon which income tax has been imposed;

(2) Interest not wholly exempt from tax received upon obligations of the United States and bonds of the War Finance Corporation;

(3) Personal exemption—

(a) In the case of single person, or married person not living with husband or wife, $1,000;

(b) In the case of married person living with husband or wife, or head of a family, $2,000;

(4) Exemption of $200 for each dependent person, other than husband or wife, under eighteen years of age or incapable of self-support because mentally or physically defective, receiving his chief support from the taxpayer.

Personal Exemption of Married Person.—In the case of a married man or a married woman the joint exemption replaces the individual exemption only if the man lives with his wife or the woman lives with her husband. In the absence of continuous actual residence together, whether or not a man or woman has a wife or husband living with him or her within the meaning of the

statute must depend on the character of the separation. If the absence of either is only temporary, the additional exemption applies. The unavoidable absence of a wife or husband at a sanatorium or asylum on account of illness does not preclude claiming the exemption. If, however, the husband voluntarily and continuously makes his home at one place and the wife hers at another, they are not living together within the meaning of the statute, irrespective of their personal relations. The personal exemption may be divided between husband and wife in any proportion agreed upon by them. A resident alien with a wife residing abroad is not entitled to the joint exemption.

"Head of Family" Defined.—A "head of a family" is a person who actually supports and maintains in one household one or more individuals who are closely connected with him by blood relationship, relationship by marriage, or by adoption, and whose right to exercise family control and provide for these dependent individuals is based upon some moral or legal obligation. In the absence of continuous actual residence together, whether or not a person with dependent relatives is a head of a family within the meaning of the statute must depend on the character of the separation. If a father or a child or other dependent is temporarily away, the common home being still maintained, the additional exemption applies. Also, if a parent is obliged to maintain his dependent children with relatives or in a boarding house while he lives elsewhere, the additional exemption may still apply. If, however, without necessity the dependent continuously makes his home elsewhere, his benefactor is not the head of a family, irrespective of the question of support. A resident alien with children abroad is not the head of a family.

Credit for Dependents.—A credit of $200 is also allowed for each person (other than husband or wife), whether related to the the taxpayer or not and whether living with him or not, dependent upon and receiving his chief support from the taxpayer, provided the dependent is either (a) under eighteen or (b) incapable of self-support because mentally or physically defective. The credit is based upon actual financial dependency and not mere legal dependency. It may accrue to a taxpayer who is not the head of a family. But a father whose children receive half or more of their support from a trust fund or other separate source is not entitled to the credit.

Date Determining Exemption.—The status of the taxpayer on the last day of his taxable year determines the amount of his credit for personal exemption and exemption for dependents. If an individual dies during the taxable year, his executor or administrator in making a return for him is entitled to claim his full personal exemption according to his status at the time of his death. If a husband or wife so dies and the joint personal exemption is used by the executor or administrator in making a return for the decedent, an undiminished personal exemption according to the status of the survivor at the end of the taxable year may be claimed in the survivor's return.

Credits to Trust or Beneficiary.—An estate or trust, where income is taxed to the fiduciary, is allowed the same credits against net income as a single person, including a personal exemption of $1,000, but no credit for dependents. In the case of an estate or trust taxed to the beneficiaries each beneficiary is allowed for the purpose of the normal tax, in addition to his individual credits, his proportionate share of such dividends from domestic and resident foreign corporations and of such interest not entirely exempt from tax upon obligations of the United States and bonds of the War Finance Corporation as are received by the estate or trust. Each beneficiary is entitled to but one personal exemption, no matter from how many trusts he may receive income.

Credits Allowed Partners and Stockholders of Personal Service Corporation.—In addition to the credits ordinarily allowed an individual*, a partner or stockholder of a personal service corporation is entitled to a credit against net income, for the purpose of the normal tax only, of his proportionate share of such dividends from corporations subject to tax and of such interest not entirely exempt from tax upon obligations of the United States and bonds of the War Finance Corporation as are received by the partnership or personal service corporation.

A stockholder of a personal service corporation is also entitled to credit, for the purpose of the normal tax, for amounts received in distribution of earnings of the corporation accumulated since February 28, 1913, and prior to January 1, 1918.

For allowance of credits to nonresident alien individuals and foreign corporations, see pages 8, 19 and 20.

*See page 5

Corporations

The net income of a corporation, other than a personal service corporation, determined by subtracting from gross income the amount of the deductions defined in the law, is the net income upon which the excess profits tax is computed, but before the application of the income tax the following credits against net income are allowed:

(a) A specific credit of $2,000 (not allowed a foreign corporation);

(b) The amount of any war profits and excess profits tax assessed or to be assessed by the United States for the same taxable year;

(c) The amount of interest received upon obligations of the United States and bonds of the War Finance Corporation, which is subject to war profits and excess profits taxes.

For the purpose of the excess profits tax a corporation is not entitled to the foregoing credits.

Return for Period Less Than a Year.—Where a return is made for a period less than a year, as in the case of a corporation making its first return of income on the basis of a fiscal year, or as in the case of a corporation changing its accounting period, whether from calendar year to fiscal year, from fiscal year year to calendar year, or from one fiscal year to another fiscal year, the specific credit of $2,000 shall be reduced to such a proportion of the full credit as the number of months in the period for which the return is made bears to twelve months.

CORPORATIONS EXEMPT FROM TAX

The following organizations are exempt from tax under Section 231 of the Law:

(1) Labor, agricultural, or horticultural organizations;

(2) Mutual savings banks not having a capital stock represented by shares;

(3) Fraternal beneficiary societies, orders, or associations (a) operaing under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system, and (b) providing for the payment of life, sick, accident, or other benefits to the members of such society, order, or association or their dependents;

(4) Domestic building and loan associations and cooperative banks without capital stock organized and operated for mutual purposes and without profit;

(5) Cemetery companies owned and operated exclusively for the benefit of their members;

(6) Corporations organized and operated exclusively for religious, charitable, scientific, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual;
(7) Business leagues, chambers of commerce, or boards of trade, not organized for profit and no part of the net earnings of which inures to the benefit of any private stockholder or indidivual;
(8) Civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare;
(9) Clubs organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, no part of the net earnings of which inures to the benefit of any private stockholder or member;
(10) Farmers' or other mutual hail, cyclone, or fire insurance companies, mutual ditch or irrigation companies, mutual or cooperative telephone companies, or like organizations of a purely local character, the income of which consists solely of assessments, dues, and fees collected from members for the sole purpose of meeting expenses;
(11) Farmers', fruit growers', or like associations, organized and operated as sales agents for the purpose of marketing the products of members and turning back to them the proceeds of sales, less the necessary selling expenses, on the basis of the quantity of produce furnished by them;
(12) Corporations organized for the exclusive purpose of holding title to the property, collecting income therefrom, and turning over the entire amount thereof, less expenses, to an organization which itself is exempt from the tax imposed by this title;
(13) Federal land banks and national farm-loan associations as provided in Section 26 of the Act approved July 17, 1916, entitled "An act to provide capital for agricultural development, to create standard forms of investment based upon farm mortgage, to equalize rates of interest upon farm loans, to furnish a market for United States bonds, to create Government depositaries and financial agents for the United States, and for other purposes";
(14) Personal service corporations.

Establishing Exemption.—In order to establish its exemption and be relieved of the necessity of filing returns of income and paying a tax, every organization claiming exemption, except personal service corporations, must file an affidavit with the collector of the district in which it is located, showing the character of the organization, the purpose for which it is organized, the sources of its income, and its disposition, whether or not any of its income is credited to surplus or may inure to the benefit of any private stockholder or individual, and, in general, all facts relating to its operation which affect its right to exemption. A copy of the charter or articles of incorporation and by-laws of the organization should

be attached to the affidavit. Upon receipt of the affidavit and other papers the collector will inform the organization whether or not it is exempt, unless there is doubt as to the taxable status of the organization, in which case he will refer the affidavit and papers submitted, to the Commissioner for decision. Once an organization has established its right to exemption, no return need be made thereafter, and no further showing is required with respect to its status unless there is a change in the character of its organization or operations or the purpose for which originally created.

INSURANCE COMPANIES

Gross Income.—In general, the gross income of insurance companies consists of their total revenue from the operation of the business, together with their income from all other taxable sources. The term also includes net premiums, that is, gross premiums less returned premiums on policies cancelled and premiums on policies not taken, investment income, profits from the sale of assets, and all other gains, profits and income reported to state insurance departments, except income specifically exempt from tax. Premiums received by mutual marine insurance companies which are paid out for reinsurance, should be eliminated from gross income and the payments for reinsurance from disbursements. Deposit premiums on perpetual risks received and returned by fire insurance companies should be treated in like manner, as no reserve will be recognized covering liability for such deposits. The earnings on such deposits must be included in the investment income. A net decrease in reserve funds required by law within the taxable year must also be included in the gross income.

The income from business relating to a foreign country which is transacted by a United States branch or agency of a foreign insurance company, must be returned as gross income.

Life Insurance Companies.—A life insurance company should not include in gross income such portion of any actual premium received from any individual policyholder as is paid back or credited to or treated as an abatement of premium of such policyholder within the taxable year. "Paid back" means paid in cash. "Credited to" means held to the credit of, including dividends applied to pay renewal premiums, purchase additional paid-up insurance, or annuities, or to shorten the endowment or premium-paying period. It does not include dividends provisionally ascer-

tained and apportioned upon deferred dividend policies. "Treated as an abatement of premium" means of the premium for the taxable year. Where the dividend paid back is in excess of the premium received from the policyholder within the taxable year, there may be excluded from gross income only the amount of such premium received. Where no premium is received from the policyholder within the taxable year, the company is not entitled to exclude from its premiums received from other policyholders any amount in respect of such dividend payment.

Deductions.—Insurance companies are entitled to the same deductions from gross income as other corporations, and also to the deduction of the net addition required by law to be made within the taxable year to reserve funds and of the sums other than dividends paid within the taxable year on policy and annuity contracts. "Paid" includes "accrued" or "incurred" (construed according to the method of accounting upon the basis of which the net income is computed) during the taxable year, but does not include any estimate for losses incurred but not reported during the taxable year. As payments on policies there should be reported all death, disability and other policy claims (other than dividends as above specified) paid within the year, including fire, accident and liability losses, matured endowments, annuities, payments on installment policies and surrender values actually paid.

Addition Required by Law to Reserve Funds.—Insurance companies may deduct from gross income the net addition required by law to be made within the taxable year to reserve funds, including in the case of assessment insurance companies the actual deposit of sums with state or territorial officers pursuant to law as additions to guarantee or reserve funds. This is considered to mean the net addition required by the specific statutes of the states within which the taxpayer transacts business. A requirement by a state insurance commissioner that a net addition shall be made to certain amounts retained to meet specified liabilities is not a net addition required by law to be made to reserve funds within the meaning of the statute. Only reserves commonly recognized as reserve funds in insurance accounting are to be taken into consideration in computing the net addition to reserve funds required by law. In the case of a fire insurance company, the only reserve fund commonly recognized is the "unearned-premium" fund.

Casualty companies may deduct losses incurred within the taxable year, but unless the net addition to the unpaid loss reserve required by law exceeds such losses incurred, no deduction for the net addition to the unpaid loss reserve may be taken. In any event, only the excess of such net addition over such losses may be deducted. In the case of life insurance companies the net addition to the "reinsurance reserve" and the "reserve for supplementary contracts not involving life contingencies," and the net addition to any other reserve funds necessarily maintained for the purpose of liquidating policies at maturity, are legally deductible. An increase in the reserve maintained by a life insurance company to pay dividends on deferred dividend policies may not be deducted from gross income. Mutual hail and mutual cyclone insurance companies are entitled to deduct from gross income the net addition which they are required to make to the "guaranty surplus" fund or similar fund.

Combined Life, Health, and Accident Policies.—Corporations which issue combined policies of life, health, and accident insurance on the weekly premium payment plan, continuing for life and not subject to cancellation, may deduct from gross income only such portion of the net addition, not required by law, made within the taxable year to reserve funds as is needed for the protection of the holders of such combined policies. In general the net addition to any fund especially maintained for the protection of such policyholders may be deducted. The determination by the company of the need for such addition is subject to review by the Commissioner, and the return of income should be accompanied by a full explanation of the basis upon which such fund and the additions to it are determined.

Mutual Marine Insurance Companies. — Mutual marine insurance companies should include in gross income the gross premiums collected and received by them less amounts paid for reinsurance. They may deduct from gross income amounts repaid to policyholders on account of premiums previously paid by them, together with the interest actually paid upon such amounts between the date of ascertainment and the date of payment thereof. The remainder of the premiums accordingly form part of the net income of the company, except to the extent that they are subject to the deductions allowed insurance companies in general and other corporations.

Mutual Insurance Companies.—Mutual insurace companies (other than mutual life and mutual marine insurance companies), which require their members to make premium deposits to provide for losses and expenses, are allowed to deduct from gross income the aggregate amount of premium deposits returned to their policyholders or retained for the payment of losses, expenses and reinsurance reserves. If, however, any portion of such amount is applied during the taxable year to the payment of losses, expenses or reinsurance reserves, for which a separate allowance is taken, then such portion is not deductible; and if any portion of such amount for which an allowance is taken is subsequently applied to the payment of expenses, losses, or reinsurance reserves, then such payment cannot be separately deducted. An amount of premium deposits retained for the payment of expenses and losses, and the amount of such expenses and losses, may not both be deducted. A company which invests part of the premium deposits so retained by it in interest-bearing securities may nevertheless deduct such part, but not the interest received on such securities. A mutual fire insurance company which has a guaranty capital is taxed like other mutual fire insurance companies. A stock fire insurance company, operated on the mutual plan to the extent of paying dividends to certain classes of policyholders, may make a return on the same basis as a mutual fire insurance company with respect to its business conducted on the mutual plan.

Returns.—Insurance companies transacting business in the United States or deriving income from sources therein, are required to file a return on Form 1120. Whenever possible, a copy of the report to the state insurance department should be submitted with the return.

FARMERS

All gains, profits, or income derived from the sale or exchange of farm products, whether produced on the farm or purchased and resold, must be included in the return for the year in which the products were actually marketed and sold, unless an inventory is used. The term "farm" embraces the farm in the ordinarily accepted sense and includes stock, dairy, poultry, fruit and truck farms, also plantations, ranches, and all land used for farming operations. All individuals, partnerships, or corporations that cultivate, operate, or manage farms for gain or profit, either as

owners or tenants, are designated farmers. A person cultivating or operating a farm for recreation or pleasure, the operation of which results in a continual loss from year to year, is not regarded as a farmer.

In the case of the sale of machinery, and of animals purchased as draft or work animals, or solely for breeding purposes and not for resale, any excess over the cost thereof, less all sums theretofore deducted for depreciation, must be included as gross income by the taxpayer. Where farm produce is exchanged for merchandise, groceries or mill products, the market value of the article or product received in exchange is to be returned as income. Rents received in crop shares are to be returned as of the year in which the crop shares are reduced to money or a money equivalent. If a farmer is engaged in producing crops which require more than a year from the time planted until they are gathered and sold, the income therefrom may be computed upon the crop basis; but the entire cost of producing the crops must be deducted for the year in which the gross income from the crops is realized. When live stock purchased is sold, its cost is to be deducted from the sales price in ascertaining the amount of gain or profit resulting. If, however, an inventory is used, the cost price of the article sold must not be taken as an additional deduction in the return, as such cost price would be reflected in the inventory.

The Treasury Department has provided a special work sheet or schedule of farm income and expenses, Form 1040-F. It may be used by farmers who work their own farms or rent them out on shares, or by tenants. If two or more farms are operated it may be desirable to fill out a separate sheet for each farm. This schedule is to be delivered to the collector, with the taxpayer's income tax return on Form 1040 or 1040-A.

Expenses Allowable.—A farmer operating a farm for profit is entitled to deduct from gross income as necessary expenses all amounts actually expended in carrying on the business. The cost of ordinary tools of short life or small cost, such as hand tools, shovels, rakes, etc., may be included. The cost of feeding and raising live stock may be treated as an expense deduction in so far as such cost represents actual outlay, but not including the farm products grown upon the farm or the labor of the taxpayer. If a farm is operated for recreation or pleasure and not on a commercial basis, and if the expenses incurred exceed the receipts therefrom,

the entire receipts from the sale of products may be ignored, and the expenses incurred, being regarded as personal expenses, will not constitute allowable deductions.

The cost of farm machines and farm buildings represents a capital investment and is not an allowable deduction as an item of expense. Amounts expended in the developing of farms, orchards, and ranches, prior to the time when the productive state is reached, may be regarded as investments of capital, as are amounts expended in purchasing draft or work animals or live stock, either for resale or for breeding purposes. The purchase price of an automobile even when wholly used in carrying on farming operations is not deductible but is regarded as an investment of capital. The cost of gasoline, repairs, and upkeep of an automobile used wholly in the business of farming is deductible as an expense. If used partly for business purposes and partly for the pleasure or convenience of the taxpayer or his family, such cost may be apportioned according to the extent of the use for purposes of business and pleasure or convenience, and only the proportion of such cost justly attributable to business purposes is deductible as a necessary expense.

Losses.—Losses incurred in the operation of farms as business enterprises are deductible from gross income. If farm products are held for favorable markets, no deduction on account of shrinkage in weight or physical value or by reason of deterioration in storage is allowable. The total loss by frost, storm, flood or fire of a prospective crop or of a crop which has not been sold is not deductible in computing net income. A farmer engaged in raising and selling stock, cattle, sheep, horses, etc., is not entitled to claim as a loss the value of animals that perish from among those animals that were raised on the farm. If live stock has been purchased and afterwards dies from disease, exposure, or injuries, or is killed by order of the authorities of a state or the United States, the actual purchase price of such stock less any depreciation which may have been previously claimed with respect to such perished live stock, and less any insurance or indemnity recovered, may be deducted as a loss. The actual cost of other property, less depreciation already allowed, destroyed by order of the authorities of a state or of the United States may also be claimed as a loss in the same manner. If, however, reimbursement is made by a state or the United States in whole or in part on account of stock killed or property destroyed, the amount received is returnable as income for the year in which reimbursement is made.

In determining the cost of stock for the purpose of ascertaining the deductible loss, there shall be taken into account only the purchase price and not the cost of any feed, pasturage or care which has been deducted as an expense of operation. Where gross income is ascertained by inventories, no deduction can be made for live stock or products lost during the year, whether purchased for resale or produced on the farm, as such losses will be reflected in the inventory by reducing the amount of live stock or products on hand at the end of the year. If an individual owns and operates a farm, in addition to being engaged in other business, and sustains a loss, the amount of loss sustained may be deducted from gross income from all sources, except where the farm is operated for recreation or pleasure, in which case no losses are deductible, as they are regarded as personal expenses.

Depreciation in the Case of Farmers.—A reasonable allowance for depreciation may be claimed on farm buildings (other than a dwelling occupied by the owner), farm machinery, and other physical property, including live stock purchased for draft, dairy, or breeding purposes, but no claim for depreciation on live stock raised, or purchased for resale will be allowed. Live stock purchased for draft, breeding, or dairy purposes or for any purpose other than resale, may be included in the inventory for each year at a figure which will reflect the reduction in value estimated to have occurred during the year through increase of age or other causes. Such reduction in value should be based on the cost and estimated life of the live stock. If an inventory is not used, a reasonable allowance for depreciation may be claimed, based upon the cost of draft and work animals and animals kept solely for breeding purposes and not for resale.

NONRESIDENT ALIENS

Gross Income.—The 1918 law provides that in the case of nonresident alien individuals and foreign corporations, gross income shall include only the gross income from sources within the United States, including interest on bonds, notes, or other interest-bearing obligations of residents, corporate or otherwise, dividends from resident corporations, and including all amounts received (although paid under a contract for the sale of goods or otherwise) representing profits on the manufacture and disposition of goods within the United States. In addition to these items of income which are specifically mentioned, there should also be included as gross in-

come, rentals and royalties from property and income from business carried on in the United States, interest on deposits in banks located in the United States, income from capital invested therein, and income from services rendered or labor performed therein.

Royalties paid to nonresident aliens under an agreement for the purchase of certain patent rights, payments being based upon the quantity of goods produced by the use of such patents, represent income accruing to nonresident aliens by reason of property owned or business carried on within the United States, and must be accounted for in the return of the recipient.

A nonresident alien owning stock in an American corporation, disposing of the same, both sale and delivery being effected in the United States, must return any profit as income, it being derived from sources within the United States.

Interest received by foreign consuls on bank deposits of personal funds in the United States constitutes income from sources within the United States, and as such is subject to tax.

Income received by nonresident aliens from partnerships and personal service corporations deriving income from sources within the United States, must be included by them in their returns in accordance with the usual rules regarding income of this character.

Income Exempt from Tax.—A nonresident alien taxpayer need not report any income which citizens are not required to report.* Salaries, wages, commissions and rents paid by domestic enterprises to nonresident alien employees for services rendered entirely in a foreign country or for property located in a foreign country, are not subject to tax as income from a source within the United States. The same is true of compensation received by nonresident alien munitions inspectors and purchasing agents from foreign governments. Dividends on stock and interest on notes of corporations organized in the United States, doing no business and owning no property therein, paid to nonresident alien individuals and corporations, are not subject to tax; nor does the tax apply to charter money or freight payments received by a foreign owner in regard to a vessel operated between the United States and foreign ports, if the recipient of the income maintains no regular agency in the United States and is not doing business therein.

Liberty Bond Exemptions.—By virtue of Section 4 of the Victory Liberty Loan Act of March 3, 1919, amending Section 3 of the Fourth Liberty Bond Act of July 9, 1918, the interest

*See page 65.

received on and after March 3, 1919, on bonds, notes and certificates of indebtedness of the United States, and bonds of the War Finance Corporation, while beneficially owned by a nonresident alien individual or a foreign corporation, partnership, or association not engaged in business in the United States, is exempt from all income and war profits and excess profits taxes, and interest on any such bonds need not be included in the taxpayer's return unless for purposes of information. Interest on bonds of nonresident corporations or of foreign governments or states, or their political subdivisions is not income from sources within the United States merely because such interest is paid by a fiscal agent in the United States and is exempt from income, war profits and excess profits taxes in the hands of a nonresident alien individual, fiduciary, partnership, or corporation.

Deductions.—In the case of nonresident alien individuals or foreign corporations the deductions* for business expenses paid or incurred, losses sustained during the taxable year incurred in trade or business, bad debts, exhaustion, wear and tear of property, amortization, depletion and depreciation of mines, oil and gas wells, other natural deposits and timber, substantial losses resulting from material reduction in the value of the inventory, and taxes imposed by the authority of any foreign country (except income, war profits and excess profits taxes and those assessed against local benefits of a kind tending to increase the value of the property assessed) upon property or business, are allowed only if and to the extent that such deductions are connected with income arising from sources within the United States, the proper apportionment and allocation of the deductions with respect to the sources of income within and without the United States being determined under regulations prescribed by the Commissioner.

A nonresident alien individual or foreign corporation is allowed as a deduction for interest paid or accrued, only the proportion of such interest which the amount of the gross income from sources within the United States bears to the amount of the gross income from all sources within and without the United States. A nonresident alien individual may deduct any losses sustained in transactions entered into for profit, though not connected with his trade or business, only as to such transactions within the United States, and any losses not connected with the trade or business, arising from fire, storm, shipwreck or other casualty or from theft, only of property

*See pages 71 to 95.

within the United States. A nonresident alien individual, but not a foreign partnership or corporation, is allowed to deduct contributions or gifts made to domestic corporations or to the Vocational Rehabilitation Fund authorized by Section 7 of the Vocational Rehabilitation Act. A foreign corporation is allowed, however, to deduct in full the amounts received as dividends from a corporation taxable on its net income or dividends received from a personal service corporation out of its earnings upon which income tax has been imposed.

A Canadian corporation which sells part of its product in the United States, and part in Canada, should report its deductions for cost of manufacture, exclusive of interest paid on its indebtedness, in the same proportion as the quantity of its products sold in the United States bears to the total quantity sold.

Allowance of Deductions and Credits.—Unless a nonresident alien individual or foreign corporation renders a full and accurate return of income, the tax will be collected on the basis of the gross income (not the net income) from any sources within the United States. Where a nonresident alien has various sources of income within the United States, so that from any one source, or from all sources combined, the amount of income subjects him to surtax, and a return of income has not been filed by him or on his behalf, the Commissioner will cause a return to be made and will include therein all such income concerning which he has information, and will assess and collect the tax without allowance for credits or deductions. The exception to the rule that a nonresident alien may only secure the benefit of the credits for the purpose of the normal tax by claiming them upon filing a return of income, is found in the case of a nonresident alien employee who files with his employer Form 1115, duly executed under oath, claiming the benefit of the credit for personal exemption or the exemption for dependents or both, to which he may be entitled as a citizen or subject of a country which either imposes no income tax or, in imposing an income tax, allows a credit for personal exemption, or credit for dependents, or both, to a citizen of the United States not residing in such country, as contemplated by Section 216 of the law.

A nonresident alien individual, who is a citizen or subject of the following countries, is entitled, for the purpose of the normal tax, to

such credit for personal exemption and exemption for dependents as his family status may warrant:

Argentina
Belgium
Bohemia
Bolivia
Bosnia
Brazil
Bucowina
Canada
Carinthia
Carniola
Chile
China
Cuba
Dalmatia
Denmark
Ecuador
Egypt
France
Galicia
Goritz
Gradisca
Herzegovina
Istria
Lower Austria
Mexico
Montenegro
Moravia
Morocco
Newfoundland
Nicaragua
Norway
Panama
Paraguay
Persia
Peru
Portugal
Roumania
Russia (including Poles owing allegiance to Russia)
Salzburg
Santa Domingo
Serbia
Siam
Silesia
Spain
Styria
Trieste
Tyrol
Upper Austria
Union of South Africa
Venezuela.

A nonresident alien individual, who is a citizen or subject of the following countries, is entitled to a credit for personal exemption, but not for dependents:

Bachka
Banat of Temesvar
Croatia
Salvador
India
Italy
Slavonia
Slovakia
Transylvania.

A nonresident alien individual, who is a citizen or subject of the following countries, is not entitled to a credit for either personal exemption or exemption for dependents:

Australia
Costa Rica
Great Britain and Ireland
Japan
The Netherlands
New Zealand
Sweden.

A nonresident alien individual who is a citizen or subject of a country not included in the foregoing lists, to obtain credit for either the personal exemption or exemption for dependents, must establish to the satisfaction of the Commissioner, that his country does not impose an income tax, or that in imposing an income tax, it grants similar credits to citizens of the United States not residing therein.

For returns of nonresident alien individuals and foreign corporations, see pages 97, 98 and 137.

PARTNERSHIPS AND PERSONAL SERVICE CORPORATIONS

Partnerships and personal service corporations as such are not subject to tax under the statute, but are required to make returns of income regardless of the amount thereof.* Individuals carrying on business in a partnership and the stockholders of a personal service corporation are, however, taxable upon their distributive shares of the net income of the partnership or personal service corporation, whether distributed or not, and are required to include such distributive shares in their returns. The net income of the partnership or personal service corporation shall be computed on the same basis as the net income of an individual, except that the deduction of contributions is not permitted.

Distributive Shares of Partners.—The distributive share of the net income of a partnership which a partner is required to include in his return is his proportionate share of the net income of the partnership, either

(a) for the taxable year upon the basis of which the net income of the partner is computed, or,

(b) if his net income is computed upon the basis of a taxable year different from that of the partnership, for the taxable year of the partnership ending within the taxable year upon the basis of which the partner's net income is computed. Amounts earned and distributed by a partnership to a partner after the end of its taxable year and before the end of his corresponding taxable year should be accounted for both by the partnership and partner in their returns for their next succeeding taxable years.

Distributive Shares of Stockholders of Personal Service Corporation.—A stockholder of a personal service corporation is required to include in his return for the taxable year the following:

(a) any dividends paid by the corporation in such year out of earnings or profits accumulated since February 28, 1913, and before January 1, 1918;

(b) his share of any distribution made by the corporation in such year out of earnings or profits accumulated since December 31, 1917, and since the close of its taxable year ending with or during his next preceding taxable year; and

(c) his distributive share of the undistributed net income of the corporation for its taxable year ending with or during his taxable year, provided he was at the close of its taxable year a stockholder in the corporation, notwithstanding he might since have ceased to be a stockholder.

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*See page 25

Personal Service Corporation Defined.—A "personal service corporation" means a corporation whose income is derived from a profession or business—

(a) which consists principally of rendering personal service;

(b) the earnings of which are to be ascribed primarily to the activities of the principal owners or stockholders; and

(c) in which the employment of capital is not necessary or is only incidental.

The term does not include:

(a) foreign corporations;

(b) corporations 50 per centum or more of whose gross income consists of income derived from trading as a principal; and

(c) corporations 50 per centum or more of whose gross income consists of income derived from Government contracts made between April 6, 1917, and November 11, 1918, inclusive.

A corporation is not a personal service corporation merely because less than 50 per centum of its gross income is derived from trading as a principal or from Government contracts, nor can a corporation be considered a personal service corporation when another corporation owns or controls substantially all its stock, or when substantially all of its stock and the stock of another corporation (not itself a personal service corporation) forming part of the same business enterprise, is owned or controlled by the same interests.

Personal Services Rendered by Personal Service Corporation.—In order that a corporation may be deemed to be a personal service corporation, its earnings must be derived principally from compensation for personal services rendered by the corporation. Merchandising or trading either in commodities or the services of others is not rendering personal service. Conducting an auction, agency, brokerage or commission business strictly on the basis of a fee or commission is rendering personal service. If, however, a corporation assumes risks of market fluctuations, bad debts, failure to accept shipments, etc., or if it guarantees accounts of the purchaser, or is in any way responsible to the seller for the payment of the purchase price, the transaction is one of merchandising or trading, even though the goods are shipped directly from the producer to the consumer. If a commission or fee is based on a difference in the prices at which the seller sells, and the buyer buys, the presumption is raised that the transaction is one of merchandising or trading, and it will be so considered in the absence of satisfactory evidence to the contrary. No weight can be given to the fact that the invested capital of the corporation or the

actual investment of the principal owners or stockholders is comparatively small. If the use of capital is necessary, or more than incidental, capital is a material income-producing factor and the corporation is not a personal service corporation. A corporation is not a personal service corporation if it carries on a business which ordinarily requires the use of capital, irrespective of whether the owners or stockholders have invested substantial capital.

Activities of Stockholders of Personal Service Corporation.—A corporation is not considered a personal service corporation, even though it renders personal service, unless

(a) the principal owners or stockholders are regularly engaged in the active conduct of its affairs, and its earnings are to be ascribed primarily to their activities; and

(b) its affairs are conducted principally by such owners or stockholders.

Where the principal owners or stockholders merely supervise or direct a force of employees, a corporation is not a personal service corporation. If employees contribute substantially to the services rendered by a corporation it is not a personal service corporation unless in every case in which such services are so rendered, the value of and the compensation charged therefor are to be attributed primarily to the experience or skill of the principal owners or stockholders. No definite percentage of stock or interest in the corporation, which must be held by those engaged in the active conduct of its affairs in order that they may be deemed to be the principal owners or stockholders, can be prescribed as a conclusive test. No corporation or its owners or stockholders shall, however, make a return in the first instance, on the basis of its being a personal service corporation unless at least 80 per centum of its stock is held by those regularly engaged in the active conduct of its affairs.

Application of Different Rates Where Fiscal Year of Partnership or Personal Service Corporation Ends in 1919.—Any deductions, exemptions or credits to which a partner in a partnership or a stockholder of a personal service corporation with a fiscal year ending in 1919 is entitled, shall first be applied against his income subject to the rates for the calendar year 1919, unless of a kind properly chargeable against income taxable at the rates for the calendar year 1918. In determining the rates of tax applicable to the amounts of the distributive shares of the partners or stockholders attributable to the calendar years 1918 and 1919, respectively, the amounts subject to the rates for the calendar year 1919 shall be placed in the lower

brackets of the rate schedule provided in the law, and the amounts attributable to the calendar year 1918 in the next higher brackets of the rate schedule applicable to that year.

Association Distinguished from Partnership.—An organization, the membership interests in which are transferable without the consent of all members, and which is conducted by trustees or directors and officers without the active participation of all members as such, is an association and not a partnership. A partnership bank conducted like a corporation and so organized that the interests of its members may be transferred without the consent of the other member, is a joint stock company or association within the meaning of the statute. A partnership bank, the interests of whose members cannot be so transferred, is a partnership.

Limited Partnerships.—So-called limited partnerships of the type authorized under the statutes of New York and most other states, Michigan and Illinois limited partnerships and a California special partnership, are partnerships and not corporations within the meaning of the statute.

In all doubtful cases limited partnerships will be treated as corporations unless they submit satisfactory proof that they are not in effect so organized.

Taxation of Partners and Stockholders of Personal Service Corporation When Fiscal Year Ends in 1919.—If the fiscal year of a partnership or a personal service corporation began in 1918 and ends in 1919, the rates of tax for the calendar year 1918 apply to each partner's or stockholder's distributive share of the net income attributable to the calendar year 1918 and the rates for the calendar year 1919 to the distributive share of each partner or stockholder of such net income attributable to the calendar year 1919. Each partner's or stockholder's distributive share for such fiscal year attributable to the calendar year 1918 and the calendar year 1919 is found by determining the net income of the partnership or personal service corporation for its entire fiscal year both in accordance with the law applicable to the calendar year 1918 and the calendar year 1919 and the distributive share thereof of each partner or stockholder, and then taking such proportion thereof as the part of such fiscal year falling within the calendar year 1918 and the calendar year 1919 bears to the full fiscal year.*

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*See Reg. 45., Arts. 326, 334.

For credits allowed partners in their individual tax returns see page 7.

Returns.—The return shall be on Form 1065, Revised,* sworn to by one of the partners, in the case of a partnership, and by the president and treasurer in the case of a personal service corporation. Such return shall be made for the taxable year of the partnership or personal service corporation, that is, for its annual accounting period, whether fiscal year or calendar year irrespective of the taxable year of the partners or stockholders. For the basis of return, where the partnership or personal service corporation makes any change in its accounting period, see pages 32 and 96.

The individual partners and the stockholders of a personal service corporation are taxable, however, upon their distributive shares of the net income of the partnership or personal service corporation, whether distributed or not, and are required to include such distributive shares in their returns.

FIDUCIARIES

Fiduciary Defined.—"Fiduciary" is a term which applies to all persons who occupy positions of peculiar confidence towards others, such as trustees, executors and administrators. A fiduciary for income tax purposes is a person who holds in trust an estate to which another has the beneficial title or in which another has a beneficial interest, or receives and controls income of another, as in the case of receivers. A committee of the property of an incompetent person is a fiduciary.

There may be a fiduciary relationship between an agent and principal, but the word "agent" does not denote a fiduciary. A fiduciary relationship cannot be created by a power of attorney. An agent having entire charge of property, with authority to effect and execute leases with tenants entirely on his own responsibility and without consulting his principal, merely turning over the net profits from the property periodically to his principal by virtue of authority conferred upon him by a power of attorney, is not a fiduciary within the meaning of the statute. In cases where no legal trust has been created in the estate controlled by the agent and attorney, the liability to make a return rests with the principal.

Classification of Estates and Trusts.—For income tax purposes, income of estates and trusts may be divided into two classes:

*1065-A, Revised, where return is made for fiscal year ending in 1919.

First: Income, the tax upon which is imposed upon the estate or trust and paid by the fiduciary, consisting of:

(a) Income received by estates of deceased persons during the period of administration or settlement, except as provided in "f" below;

(b) Income accumulated in trust for the benefit of unborn or unascertained persons, or persons with contingent interests;

(c) Income held in trust for future distribution under the terms of the will or trust;

Second: Income, the tax upon which is imposed upon and paid by the beneficiary, consisting of:

(d) Income which is to be distributed to beneficiaries periodically, whether or not at regular intervals;

(e) Income collected by the guardian of an infant to be held or distributed as the court may direct;

(f) Income of the estate of any deceased person which during the period of administration or settlement is properly paid or credited to any beneficiary.

Income of Estates and Trusts Taxed to Fiduciary.—In the case of estates or trusts falling within subdivisions (a), (b) and (c), the income is taxed to the fiduciary as to any single individual, except that in cases falling under (a) there may first be deducted from the income of the decedent's estate any income properly paid or credited to any beneficiary. Such return shall be on Form 1040, Revised, except that it may be on Form 1040-A, Revised, where the net income does not exceed $5,000 for the individual, estate or trust for which the fiduciary acts.

Income of Estates and Trusts Taxed to Beneficiaries.—In the case of estates and trusts falling under (d), (e) and (f), the fiduciary is required to make an information return on Form 1041, Revised, in which must be included a statement of each beneficiary's distributive share of the net income of the estate or trust, whether or not distributed before the close of the taxable year for which the return is made. In all such cases, the income is taxable directly to the beneficiary or beneficiaries, who must make a return on Form 1040, Revised, or 1040-A, Revised. Each beneficiary must include in his return his distributive share of the net income, whether distributed or not. If the taxable year on the basis of which he makes his return fails to coincide with the annual accounting period of the estate or trust, then he need only include in his return his distributive share for such accounting period ending within his taxable year.

Return by Fiduciary.—Every fiduciary, or at least one of joint fiduciaries, must make a return of income for the individual estate or trust whose income is in his charge,

(a) If the net income of any individual beneficiary is $2,000 or over if married, and living with husband or wife, or is $1,000 or over in other cases,

(b) If the net income of the estate or trust is $1,000 or over, or

(c) If any beneficiary is a nonresident alien.

Where, under the terms of the will or deed, the trustee may in his discretion distribute or accumulate the income, such income is taxed to the trustee, irrespective of his exercise of discretion, and the fact that the ultimate beneficiary may be a person exempt from tax does not affect the imposition of the tax. A statutory allowance paid a widow out of the corpus of the estate is not deductible from gross income. As an intestate's real estate does not pass to his administrator, upon the sale by heirs, whether before or after settlement of the estate, each heir is taxed individually on any profit derived. In the case of a decedent, if the net income from the beginning of the taxable year to the date of death was $1,000, if unmarried, or $2,000, if married and living with husband or wife, the executor or administrator shall make a return for the decedent on Form 1040, Revised, or Form 1040-A, Revised, as the case may be.

Where a citizen or resident fiduciary has control of income distributable to a nonresident alien beneficiary, the fiduciary must make a return for such nonresident alien on Form 1040, Revised, or 1040-A, Revised, and pay the tax. If there are two or more beneficiaries, the fiduciary must render an information return on Form 1041, Revised, and also a return on Form 1040, Revised, or 1040-A, Revised, for each nonresident alien beneficiary.

Return by Guardian or Committee.—A fiduciary acting as the guardian of a minor, or as the committee of an insane person, having a net income of $1,000 or $2,000, according to the marital status of such person, must make a return for such minor or incompetent on Form 1040, Revised, or Form 1040-A, Revised, and pay the tax. In case the minor makes the return or causes it to be made the fiduciary need not make another return.

Returns Where Two Trusts.—In the case of two or more trusts, the income of which is taxable to the beneficiaries, the trusts being created by the same person and in charge of the same trustee, the trustee shall make a single return on Form 1041, Revised, for all such trusts, notwithstanding that they may arise from different instruments. When, however, a trustee holds trusts created

by different persons for the benefit of the same beneficiary, he shall make a return on Form 1041, Revised, for each trust separately.

Return by Receiver.—A receiver acting for an individual must render a return of income on Form 1040, Revised, or Form 1040-A, Revised, and pay the tax for his trust, but a receiver of only part of the property of an individual need not do so. A receiver of the rents and profits appointed to hold and operate a mortgaged parcel of real estate, but not in control of all the property or business of the mortgagor, and a receiver in partition proceedings, are not required to render returns of income. In general, statutory receivers and common law receivers of all the property or business of an individual must make returns.

Decedent's Estate During Administration.—The "period of administration or settlement of the estate" is the period required by the executor or administrator to perform the ordinary duties pertaining to administration, particularly the collection of assets and the payment of debts and legacies. It is the time actually required for this purpose, whether longer or shorter than the period specified in the local statute for the settlement of estates. Where an executor, who is also named as trustee, fails to obtain his discharge as executor the period of administration continues up to the time when the duties of administration are completed.

Computation of Income of Estates and Trusts.—The net income of an estate or trust shall be computed in the same manner and on the same basis as the net income of an individual, except that, in lieu of the deduction for contributions allowed to an individual, there shall be allowed as a deduction from the gross income any part thereof which during the taxable year is, pursuant to the will or trust deed, paid to or permanently set aside for the United States, a state, a territory or any political subdivision thereof, or the District of Columbia, or any corporation or association, organized and operated exclusively for religious, charitable, scientific or educational purposes or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual. No taxable income is realized from the passage of property to the executor or administrator on the death of the decedent, even though it may have appreciated in value since the decedent acquired it. In the event of delivery of property in kind to a legatee or distributee, no income is realized.

Gain or Loss from Sale of Property Included in Original Trust or Estate.—The profit or loss from the sale or other disposition of property included in the original trust or estate is the difference between the selling price and the fair market value of the property at the time of the decedent's death or at the date of the creation of the trust, unless the decedent's death occurred or the trust was created prior to March 1, 1913, in which case the fair market value upon that date is the basis for determining gain or loss. Profit derived from the sale or other disposition of assets of a trust or estate, even though considered a capital asset of the trust or estate, is taxable income.

Losses Sustained by Estates or Trusts as Affecting Taxable Income of Beneficiaries.—The Treasury Department has ruled that—

> (a) Any loss resulting from the sale of stocks, bonds, or other property owned by a trust, considered an allowable deduction from the gross income of an individual, is an allowable deduction from the gross income of a trust, whether or not the income of such trust is "to be distributed to the beneficiary periodically, whether or not at regular intervals," and whether or not there is any requirement in the instrument creating the trust, a decree of court, or a general law that the principal of the trust estate be kept intact at the expense of income as against such loss; that
> (b) Such a deduction is not allowable as against the current or future gross income of the present beneficiaries or of those who will receive the property at the termination of the trust; and that
> (c) A beneficiary is not required to include in his personal return as a part of "his distributive share, whether distributed or not, of the net income of the trust for the taxable year," any part of the amounts allowed to the trust as a whole as a deduction for loss resulting from the sale of the property.

Deductions Allowed Estates and Trusts.—Distinction is made between (1) expenses which are charges against the corpus of an estate when created and (2) expenses which are incident to the business management of the estate. In computing net income items falling under (1) are not proper deductions, whereas items falling under (2) are proper deductions.

In accordance with the foregoing, executor's commissions, court costs, and attorney's fees in connection with the settlement of an estate or the creation of a trust, which are directly chargeable to the corpus of the estate or trust, are not proper deductions in determining net income. Likewise, expenses incurred by a legatee or other person in litigation to sustain or upset a will are not proper deductions in determining net income. On the other hand, if trus-

tees' commissions are deducted from the income of the estate or trust distributable among the beneficiaries, the amount of such commissions should be entered as legitimate and necessary expenses properly deductible by the fiduciary for income tax purposes.

Expenses necessary to carrying on the business of the trust or estate by the fiduciary are deductible in the same manner as similar expenses of an individual. Likewise, interest, taxes and losses are subject to the same general rules relating to these deductible items as apply to individuals.

PART II. INCOME TAX—NET INCOME

DETERMINATION OF NET INCOME

Net income means gross income less allowable deductions, and is determined in accordance with the method of accounting regularly employed in keeping the books of the taxpayer

Net income is computed with respect to a fixed period, usually twelve months, such period being known as the taxable year. Items of income and of deductions, both of which are elements in the computation of net income, need not be in the form of cash, it being sufficient that if otherwise properly included in the computation they can be valued in terms of money. The time as of which any item of income or any deduction is to be accounted for must be determined in the light of the fundamental rule that the computation shall be made in such a manner as to clearly reflect the taxpayer's income. If the accounting method regularly employed clearly reflects his income, it must be followed with respect to the time as of which items of gross income and deductions are to be accounted for. If the taxpayer does not regularly employ a method of accounting clearly reflecting his income, the computation must be made in such manner as in the Commissioner's opinion does clearly reflect it.

Basis for Computing Net Income.—Approved standard methods of accounting will ordinarily be regarded as clearly reflecting income but no method will be so regarded unless all items of gross income and all deductions are treated with reasonable consistency. All items of gross income must be included in the return for the taxable year in which they are received and deductions taken accordingly, unless they are properly accounted for as of a different period in accordance with some other approved method of accounting. In every case the return must be made on a basis clearly reflecting the income of the taxpayer. One of two methods should be employed, the cash or receipt and disbursement basis or the accrual basis which are explained hereafter. No uniform method of accounting can be prescribed, the law contemplating that each taxpayer shall adopt such methods as are best suited to his purpose, but he must make a return of his true income and must, therefore,

maintain such accounting records as will enable him to do so. Among the essentials are the following:

(1) In all cases in which the production, purchase or sale of merchandise of any kind is an income-producing factor inventories of the merchandise on hand (including finished goods, work in process, raw materials and supplies) should be taken at the beginning and end of the year and used in computing the net income of the year;

(2) Expenditures made during the year should be properly classified as between capital and income, that is to say, that expenditures for items of plant, equipment, etc., which have a useful life extending substantially beyond the year should be charged to a capital account and not to an expense account; and

(3) In any case in which the cost of capital assets is being recovered through deductions for wear and tear, depletion or obsolescence any expenditure (other than ordinary repairs) made to restore the property or prolong its useful life should be charged against the property account or the appropriate reserve and not against current expenses.

Accounting Period.—A taxpayer's return is made and his income is computed for his taxable year, which means his fiscal year, or the calendar year if he has not established a fiscal year. Fiscal year means an accounting period of twelve months ending on the last day of any month other than December. No fiscal year will be recognized unless before its closing it was definitely established as an accounting period by the taxpayer and the books were kept in accordance therewith. The taxable year 1919 is the calendar year 1919, or any fiscal year ending therein.

Accounting Period Changes.—Where a taxpayer changes his accounting period, and not merely his taxable year to conform with his existing accounting period, he must give, as soon as possible, a written notice of such change and his reasons therefor to the collector for transmission to the Commissioner. The latter will not approve a change of the basis of computing net income, unless such notice is given at a time which is both at least thirty days before the due date of the taxpayer's return on the basis of his existing taxable year and at least thirty days before the due date of his return on the basis of the proposed taxable year. If the change is approved by the Commissioner, the taxpayer must thereafter make his returns on the basis of the new accounting period.

INVENTORIES

In order to reflect the net income correctly inventories must be taken by the taxpayer at the beginning and end of each year in

every case in which the production, purchase or sale of merchandise is an income-producing factor. Inventories should include raw materials and supplies on hand that have been acquired for sale, consumption, or use in productive processes, together with all finished or partly finished goods. Title to merchandise included in the inventory should be vested in the taxpayer, goods merely ordered for future delivery and for which no transfer of title has been effected being excluded. Merchandise sold but not shipped to the customer at the date of the inventory should be included, together with any merchandise out upon consignment, unless such goods have been included in the sales of the taxable year, in which case they should not be taken in the inventory. It should also include merchandise purchased, although not actually received, to which title has passed to the purchaser, and there should be taken into the accounts all invoices or other charges in respect of merchandise properly included in the inventory but which is in transit or which for other reasons has not been reduced to physical possession.

Valuation of Inventories.—Inventories should be valued at cost, or cost or market whichever is lower. The basis adopted must be applied to each item and not merely to the total of the inventory. Thus, if the second method is adopted the value of each item in the inventory will be measured by market, if that is lower than cost, or by cost if lower than market. The taxpayer, regardless of his past practice, was allowed to adopt the basis of cost or market, whichever is lower, for his 1918 inventory, provided a disclosure of the change was made in the return. Thereafter changes may be made only after permission is received from the Commissioner. Inventories should be recorded in a legible manner and properly computed and summarized and should be preserved as a part of the accounting records of the taxpayer. Goods taken in the inventory which have been so intermingled that they cannot be identified with specific invoices will be deemed to be the goods most recently purchased.

Inventories at Cost.—"Cost" means (1) in the case of merchandise purchased, the invoice price less trade or other discounts, except strictly cash discounts approximating a fair interest rate, which may be deducted or not at the option of the taxpayer, provided a consistent course is followed, plus transportation or other necessary charges incurred in acquiring possession of the goods; (2) in the case of merchandise produced by the taxpayer (a) the cost of raw materials and supplies entering into or consumed in

connection with the product, (b) expenditures for direct labor, (c) indirect expenses, incident to the production of the particular article, including in such indirect expenses a reasonable proportion of management expenses, but not including any cost of selling or return on capital whether by way of interest or profit. In any industry in which the usual rules for computation of cost of production are inapplicable, costs may be approximated upon such basis as may be reasonable and in conformity with established trade practice in the particular industry.

Inventories at Market.—"Market" means the current bid price prevailing at the date of the inventory for the particular merchandise, and is applicable to goods purchased and on hand and to basic materials in goods in process of manufacture and in finished goods on hand, exclusive, however, of goods on hand or in process of manufacture for delivery upon firm sales contracts at fixed prices entered into before the date of inventory. Where no open market quotations are available the taxpayer must use such evidence of a fair market price at the date or dates nearest the inventory as may be available to him, such as specific transactions in reasonable volume entered into in good faith, or compensation paid for cancellation of contracts for purchase commitments. The burden of proof will rest upon the taxpayer in each case to satisfy the Commissioner of the correctness of the prices adopted. It is recognized that in the latter part of 1918, by reason among other things of governmental control not having been relinquished, conditions were abnormal and in many commodities there was no such scale of trading as to establish a free market. In such a case, when a market has been established during the succeeding year, a claim may be filed for any loss sustained in accordance with the provisions of Section 214 (a) (12) or Section 234 (a) (14) of the law.

Inventories by Dealers in Securities.—A dealer in securities, who in his books of account regularly inventories unsold securities on hand either (a) at cost or (b) at cost or market value, whichever is lower, may make his return upon the basis upon which his accounts are kept if a description of the method employed is included in or attached to the return, and all securities are inventoried by the same method and such method adhered to in subsequent years, unless another is authorized by the Commissioner. A "dealer in securities" is a merchant of securities, whether an individual, partnership, or corporation, with an established place of business, regularly engaged in the purchase of securities and their

resale to customers, that is, one who as a merchant buys securities and sells them to customers with a view to the gains and profits that may be derived therefrom. If such business is simply a branch of the activities carried on by such person, the securities inventoried as here provided may include only those held for purposes of resale and not for investment. Taxpayers who buy and sell or hold securities for investment or speculation, and not in the course of an established business, and officers of corporations and members of partnerships, who in their individual capacities buy and sell securities, are not dealers in securities within the meaning of this rule. A bank or other institution having a regularly established department for the merchandising of securities is entitled to inventory its securities acquired and held for resale as though it were solely a dealer in securities.

BASIS FOR DETERMINING GAIN OR LOSS

For the purpose of ascertaining the gain or loss resulting from the sale or exchange of property, the basis is its fair market price or value as of March 1, 1913, if acquired prior thereto, or if acquired on or after that date, its cost or its approved inventory value, proper adjustment being made in each case for any depreciation or depletion sustained. What the fair market price or value was on March 1, 1913, is a question of fact to be established by any evidence which will reasonably and adequately make it appear, and no method of determining this value can be stated which will meet all circumstances. The fair market price or value as of March 1, 1913, is held to be the fair market price or value as of the entire day, and in case of variations between the opening and closing prices for the day, to be the average price. This would be conditioned upon showing that the exchange quotation represented a fair market price or value of the stock, since that is what controls. The fair market value as of March 1, 1913, has no bearing on the determination of invested capital of a corporation for the purpose of the war profits and excess profits tax.

The cost of property acquired on or after March 1, 1913, is the actual price paid for it, plus expenses incident to its procurement in the first instance and the sale thereafter, and the cost of improvements and development, if any.

Sale of Property Acquired by Gift or Bequest.—The basis for determining gain or loss on a sale of property acquired by gift, bequest, devise, or descent is the fair market price or value

of such property on the date of acquisition or as of March 1, 1913, if acquired prior thereto. For the purpose of determining the profit or loss from the sale of property acquired by bequest, devise or descent, since February 28, 1913, its value as appraised for the purpose of the Federal estate tax, or in the case of estates not subject to that tax, its value as appraised in the state court for the purpose of state inheritance taxes, should be deemed to be its fair market value when acquired.

Exchanges of Property.—Gain or loss arising from the acquisition and subsequent disposition of property is realized when, as the result of a transaction between the owner and another person, the property is converted into cash or into property that is essentially different from the property disposed of and that has a market value. A change in substance and not merely in form; and a change into the equivalent of cash are required to complete or close a transaction from which income may be realized. Thus, if a man owning ten shares of listed stock exchanges his stock certificate for a voting trust certificate, no income is realized, the conversion being merely in form. If, however, he exchanges his stock for a Liberty bond, income may be realized because the conversion is into independent property having market value. The property received in exchange may be real estate, personal property, or a chose in action. The exchange of a so-called convertible bond for stock, pursuant to such a privilege granted in the bond, will produce income if the stock received in exchange has a fair market value in excess of the cost or fair market value as of March 1, 1913, of the bond.

Determination of Gain or Loss from Exchange of Property.—The amount of income derived in the case of an exchange of property, as of stock for a bond, is the excess of the fair market value at the time of exchange of the bond received in exchange over the original cost of the stock exchanged for it, or over the fair market price or value of such stock as of March 1, 1913, if acquired prior thereto. The amount of income derived from a subsequent sale of the bond for cash is the excess of the amount so received over the fair market value of such bond when acquired in exchange for the stock. On the other hand, if the property received in exchange is substantially the same property or has no market value, then no gain or loss is realized, but the new property is to be regarded as substituted for the old, and upon a

sale of the new property the amount of income derived is the excess of the amount so received over the cost or fair market value as of March 1, 1913, of the old.

Exchange of Different Kinds of Property.—If property is exchanged for two different kinds of property, such as bonds and stock, the bonds having a market value and the stock none, the value of the bonds is to be compared with the cost, or fair market value as of March 1, 1913, of the original property, as the case may be. If the market value of the bonds is less than such cost or value, the difference represents the cost of the stock. If the market value of the bonds is greater than such cost or value, the difference is taxable income at the time of the exchange, and whenever sold, the entire proceeds of the stock will be taxable.

If property is exchanged for two different kinds of property, such as bonds and stocks, neither having a market value, the cost or fair market value as of March 1, 1913, of the original property should be apportioned, if possible, between the bonds and the stocks for the purpose of determining gain or loss on subsequent sales. If no fair apportionment is practicable, no profit on any subsequent sale of any part of the bonds or stock is realized until out of the proceeds of sales there shall have been recovered the entire cost or fair market value as of March 1, 1913, of the original property.

Exchange of Property for Stock.— Where property is transferred to a corporation in exchange for its stock, the exchange constitutes a closed transaction and the former owner of the property realizes a gain or loss if the stock has a market value, and such market value is greater or less than the cost or the fair market value as of March 1, 1913, (if acquired prior thereto) of the property given in exchange. Stock is to be regarded as ordinarily having a market value, even though no actual market for it can be established. In this sense, therefore, market value may be regarded as the price which might reasonably be presumed would be agreed upon between a willing buyer and a willing seller.

Exchange of Stock for Other Stock of No Greater Par Value.—Treasury Decision 2924, dated September 26, 1919, has amended Article 1567, of Regulations 45 so as to provide as follows:

In general, where two (or more) corporations unite their properties by either (a) the dissolution of corporation B and the sale of its assets to corporation A, or (b) the sale of its property by B to A

and the dissolution of B, or (c) the sale of the stock of B to A and the dissolution of B, or (d) the merger of B into A, or (e) the consolidation of the corporations, no taxable income is received from the transaction by A or B or the stockholders of either, provided the sole consideration received by B and its stockholders in (a), (b), (c), and (d) is stock or securities of A, and by A and B and their stockholders in (e) is stock or securities of the consolidated corporation, in any case of no greater aggregate par or face value than the old stock and securities surrendered. The term "reorganization," as used in Section 202 of the statute, includes cases of corporate readjustment where stockholders exchange their stock for the stock of a holding corporation, provided the holding corporation and the original corporation, in which it holds stock, are so closely related that the two corporations are affiliated as defined in Section 240 (b) of the statute and Article 633 of Regulations 45, and are thus required to file consolidated returns. So-called "no-par-value stock" issued under a statute or statutes which require the corporation to fix in a certificate or on its books of account or otherwise an amount of capital or an amount of stock issued which may not be impaired by the distribution of dividends, will for the purpose of this section be deemed to have a par value representing an aliquot part of such amount, proper account being taken of any preferred stock issued with a preference as to principal. In the case (if any) in which no such amount of capital or issued stock is so required, "no-par-value stock" received in exchange will be regarded for purposes of this section as having in fact no par or face value, and consequently as having "no greater aggregate par or face value" than the stock or securities exchanged therefor.

Determination of Gain or Loss from Subsequent Sale.—The new stock and securities received as described in the preceding paragraph take the place of the old stock and securities. For the purpose, therefore, of ascertaining the gain derived or loss sustained from the subsequent sale of any stock of A or of the consolidated corporation so received, the original cost to the taxpayer or the fair market value as of March 1, 1913, of the stock of B or A in respect of which the new stock was issued, less any untaxed distribution made to the taxpayer by A out of the former capital or surplus of B, or by the consolidated corporation out of the former capital or surplus of A or B, is the basis for determining the amount of such gain or loss. Similarly, the cost after reorganization, merger, or consolidation of the assets of A or of the consolidated corporation

is the sum of the cost (or the fair market value as of March 1, 1913) of the assets of A and of B for the purpose of ascertaining the gain or loss upon a subsequent sale. The new invested capital of A or of the consolidated corporation is to be determined as if A and B were rendering a consolidated return as affiliated corporations.

Exchange of Stock for Other Stock of Greater Par Value.—If in the case of any reorganization, merger or consolidation the aggregate par or face value of the new stock or securities received is in excess of the aggregate par or face value of the stock and securities exchanged, income will be realized from the transaction by the recipients of the new stock or securities to an amount limited by (a) the excess of the par or face value of the new stock or securities over the par or face value of the old and (b) the excess of the fair market value of the new stock or securities over the cost or fair market value as of March 1, 1913, of the old. In other words, the taxable profit will be (a) or (b), whichever is less. Upon a subsequent sale of the new stock or securities their cost to the taxpayer will be the cost or fair market value as of March 1, 1913, of the old stock and securities, plus the profit taxed on the exchange.

Readjustment of Partnership Interests.—When a partner retires from a partnership, or it is dissolved, he realizes a gain or loss measured by the difference between the price received for his interest and the cost to him, or if acquired prior to March 1, 1913, the fair market value as of that date, of his interest in the partnership, including in such cost or value the amount of his share in any undistributed partnership net income earned since February 28, 1913, on which the income tax has been paid. If, however, the partnership distributes its assets in kind and not in cash, the partner realizes no gain or loss until he disposes of the property received on distribution. Whenever a new partner is admitted to a partnership, or any existing partnership is reorganized, the facts as to such change or reorganization should be fully set forth in the next income tax return in order that the Commissioner may determine whether any gain or loss has been realized by any partner.

GROSS INCOME

In General

Except for certain special provisions relating to insurance companies, the gross income of an individual, fiduciary, partnership, or

corporation include all gains, profits, and income derived from

(1) salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid;

(2) professions, vocations, trades, businesses, commerce, or sales;

(3) dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property;

(4) interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit; and

(5) income derived from any source whatever, not specifically made exempt.

The law specifically excludes certain other items from gross income which will be found under the caption of "Exempt Income."

When Income Should Be Reported.—All items of gross income must be included in the return of income for the taxable year in which received, unless included when they accrue under certain specified methods of accounting heretofore mentioned.* In view of the unusual conditions prevailing at the close of the year 1918, the Department has recognized that many items of gross income, such as claims for compensation under cancelled contracts, together with claims against contracting departments of the Government for amortization and other matters, while properly constituting gross income for the year 1918, were undecided and not sufficiently definite in amount to be reported in the original return for that year. In such cases the taxpayer should have attached to his return a full statement of such pending claims and other matters, and when the correct amount of these items is ascertained an amended return for that year should be filed.

A person may sue in one year upon a pecuniary claim or for property, but money or property recovered on a judgment therefor rendered in a later year would be income in that year, assuming that it would have been income in the earlier year if then received. This is true of a recovery for patent infringement. Bad debts or accounts charged off because deemed to be worthless and subsequently recovered by suit or otherwise, represent income for the year in which recovered, irrespective of when the amounts were charged off.

Actual and Constructive Receipt.—Income may be received by a taxpayer in two ways, namely, by actual receipt or constructive receipt. The former is had when income is reduced to possession; the latter when income is credited or made available to the recipient, as in the case of interest on bank deposits which is

*See page 31.

credited to the depositor's account. In either case the amount received or credited must be returned as income unless it comes within one of the classes of exempt income.

Items of income need not be actually reduced to possession to become subject to tax. Income credited to the account of or set apart for a taxpayer, and which may be drawn against by him at any time, is subject to tax for the year during which so credited or set apart. In order to constitute receipt it is necessary in such cases for the income to be credited without any substantial limitation or restriction as to the time or manner of payment or condition upon which payment is to be made, and where book entries are made they should indicate an absolute transfer from one account to another. If the income is not credited, but is merely set apart, it must be unqualifiedly subject to the taxpayer's demand before it acquires the status of taxable income. Therefore, where a corporation contingently credits its employees with bonus stock, the latter not becoming available to the employees until the end of five years of employment, the mere crediting on the books of the corporation does not constitute receipt by the employees.

Where interest coupons mature, but are not cashed, the interest payment is available to the taxpayer and must be included in his return for the year in which the coupons mature, even though they are later exchanged for other property instead of eventually being cashed. The fact that it was impracticable to cash the coupons for any reason does not alter the rule. Interest credited on savings bank deposits, even though the bank nominally has a rule that it may require so many days' notice in advance of cashing depositors' checks, is income to the depositor when credited. An amount credited to shareholders of a building and loan association, when such credit passes without restriction to the latter, represents taxable income for the year of the credit, but where the amount of such accumulation is not available to the shareholder until the maturity of the share, the amount of any share in excess of the original amount paid in by the shareholder, is taxable income for the year of the maturity of the share.

Medium of Payment.—The form of payment is immaterial in determining whether or not income has been received by the taxpayer, services especially being frequently compensated for with securities or something else, the value of which is ascertainable in terms of money. Thus, where services are rendered for a stipulated price and paid for with something other than money, the stipulated

value of such services in terms of money is the value at which the thing taken in payment is to be considered for the purpose of determining the income received, the stipulated price, in the absence of evidence to the contrary, being presumed to be the fair value of the compensation received. If there is no stipulation as to the value of the services and the payment is made with something other than money, the fair market value of the thing received in payment is the amount to be included as income by the recipient.

Payment in Tax-Exempt Securities.—Payments of income made in Liberty Bonds or other obligations of the United States, or of a state, or in other securities, whether or not tax-exempt, must be included in the gross income of the taxpayer as though made in cash, the security assuming the character of cash by reason of its use as a medium of payment.

Promissory Notes as Payment.—A promissory note received in settlement of an account is in effect a payment of such account, and so much of the amount of the note as represents net income is subject to tax for the year in which received. Promissory notes received in payment for services, and not merely as security therefor, represent income to the amount of their fair market value. A taxpayer receiving as compensation a note regarded as good for its face value at maturity, but not bearing interest, may properly treat as income as of the time of receipt the fair discounted value of the note at such time. Thus, if it appears that such a note is or could be discounted on a six or seven per cent. basis, the recipient may include it in his gross income to the amount of the face value, less discount computed at the prevailing rate for such transactions. If the payments due on a note so accounted for are met as they become due, there should be included as income in respect of each such payment so much thereof as represents recovery for the discount originally deducted.

Income From Personal Services

In general, income from personal services includes all salaries, wages, commissions, bonuses, fees, and compensation of whatever kind and in whatever form paid, unless specifically exempt from tax.

The form in which the compensation is paid is immaterial. Compensation paid to an employee of a corporation in its stock is to be treated as though the corporation sold the stock for its market value, and paid the employee in cash. Where an employer, for his own convenience, furnishes to his employees, living quarters such

as camps, the ratable value need not be added to the cash compensation of the employee, but where a person receives a salary as compensation for services and also living quarters, the value of the quarters constitutes taxable income. If the employer, in addition to paying a salary, agrees with an employee to furnish him with room and board, the employee should place a fair rental value upon the room and a fair value upon the meals furnished, and these amounts should be reported as income. Premiums paid by an employer on life, accident or health insurance policies in favor of his employees as additional compensation, are income to the employees.

Treatment of Compensation.—Compensation is the purchase price of services and must compensate not only in form but in fact. It is in general just to assume that reasonable and true compensation ordinarily means only such as would be paid for like services, by like enterprises, in like circumstances. The circumstances to be taken into consideration are those existing when the contract for services was made; not those existing when the contract is questioned. While, any form of contingent compensation invites scrutiny as a possible distribution of earnings, it does not follow that payments on a contingent basis are to be treated fundamentally on a basis different from that applying to compensation paid at a flat rate. Generally speaking, if contingent compensation is paid in pursuance of a free bargain between the enterprise and the individual, made before the services are rendered, not influenced by any consideration on the part of the employer, except that of securing on fair and advantageous terms, the services of the individual, it should be allowed as a deduction, even though in the actual working out of the contract it may prove greater than the amount which would ordinarily be paid.

In case of a corporation with a limited number of stockholders, practically all of whom draw salaries which are based upon or bear a close relationship to the stockholdings of the officers or employees, it would seem that such salaries, if in excess of those ordinarily paid for similar services, are not paid wholly for services rendered, but partly as a distribution of earnings upon the stock. The amount of excess in such cases should be treated as dividends, which would be subject only to the surtax in the hands of the recipients. In the case of a corporation controlled by salaried employees by reason of their holding directly or indirectly a majority of its stock, or in the case of a large corporation with many stockholders owning a substantial minority of its stock, the tendency of

the officers to unduly inflate their salaries must be considered. If so-called payments of salaries represent an appropriation of assets of the corporation by officers, who control it and fix their compensation in violation of the rights of the corporation, they should be treated as compensation of the individuals subject to the normal tax, the fact that they are illegally secured not affecting their status as income.

An ostensible salary may be in part payment for property. This may occur where a partnership sells out to a corporation, the former partners agreeing to continue in the service of the latter. In such a case, it may be found that the salaries paid the former partners are not merely for services, but in part constitute a payment for the transfer of their business. In the case of excessive payments by individuals or partnerships, amounts disallowed should ordinarily be treated as shares of the profits of a partnership, except that a payment for property should be treated by the individual or partnership as a capital expenditure and by the recipient as part of the purchase price.

Time of Reporting Compensation.—Where no determination of compensation is had until the services are completed the amount received is income for the year of its determination.

Where an employee receives only part of the salary due him during the year because of the fact that his employer is in financial straits, and in a subsequent year receives his salary in full, together with the balance owing him on account of the previous year, he must report the back salary as income as of the year of its receipt. It is otherwise if the recipient's books are kept on an accrual basis, or if the salary owing him for prior years and not then received was credited to him by the employer and treated by him as income in his return for such years. In this connection, income credited or made available to the taxpayer, as heretofore stated, constitutes a constructive receipt by him and must be returned as income for the year in which credited or made available to him. Accordingly, if a person paid on a commission basis, earns $10,000 during the taxable year which is credited to him, against which only $4,000 has been withdrawn by him, he must report the full amount credited during the year, namely $10,000.

Bonuses.—So-called bonuses, or sums paid in addition to the stipulated salaries or wages of employees, constitute taxable income when made in good faith and as additional compensation for services actually rendered by the recipients. If the bonus is not compen-

sation for services rendered but a pure gift or gratuity on the part of the employer without any element of compensation, or if it exceeds reasonable compensation for the services rendered, it is not taxable in the hands of the recipient and cannot be deducted by the employer as an expense of the business.

Compensation of Federal Officers and Employees.—The compensation derived from office by the President of the United States, the judges of the Supreme and inferior courts of the United States, and all other officers and employees, whether elected or appointed, of the United States, Alaska, Hawaii, or any political subdivision thereof, or the District of Columbia, is subject to tax. Salaries of officers or employees of a state or any political subdivision thereof are also subject to tax when paid by the United States Government.

Mass Offerings, Fees, Tips, etc.—Marriage fees, Easter and baptismal offerings, sums paid for saying Masses for the dead and similar amounts received by clergymen and others for services rendered, represent taxable income, but Christmas gifts to such persons are not taxable, being regarded as pure gratuities and not as compensation for services rendered. Tips to waiters, porters, and others are regarded as given in consideration of services rendered and should therefore be reported as income by the recipients.

Commissions.—Commissions paid to salesmen, compensation for services on the basis of a percentage of the net profits of a business, commissions paid to real estate agents for managing or renting property, commissions paid on insurance premiums and other commissions, not expressly exempt, are subject to tax.

Compensation of Trustees.—Fees or other compensation of trustees, executors, administrators, and other persons acting in a fiduciary capacity must be reported as income for the year in which received, and where the amount due the fiduciary for his services for a period of years is not determined until the trust is terminated, the amount of his compensation must be returned in full, subject to allowable deductions, as income for the year in which paid and cannot be prorated over the period of his trusteeship.

Pensions.—Retired allowances or pensions paid by the United States, private institutions or private individuals, but not those paid by states, are regarded as compensation for past services rendered and are taxable as such.

Income from Trade, Business, or Commerce

Mercantile Business.—The gross income from a mercantile or merchandising business includes in general the total sales during the year, less the cost of goods sold, plus any income that may be derived from investments and from incidental or outside operations or sources. The gross income is actually ascertained by deducting from the total sales during the year and the income from incidental and outside operations the net cost of goods sold. The net cost of goods sold is obtained by adding the cost of labor upon the goods, the cost of materials and supplies, the cost of merchandise bought for sale, and other costs properly chargeable against the goods (not including business deductions) to the inventories at the beginning of the year, and deducting therefrom the inventories at the end of the year. No subtractions should be made in determining gross income, for depreciation, depletion, selling expenses or losses, or for items not ordinarily used in computing the cost of goods sold. These must be taken as deductions in the return in ascertaining net income. The taxpayer must include also all amounts received as allowance for amortization from whatever source and by whatever name called, since the allowance authorized by the law must be taken by way of a deduction from gross income. Therefore, if any allowance to the taxpayer is made by a contracting department of the Government, or by any other contractor for amortization or fall in the value of the property, either as part of the cost of production or as a part of the price of the product, such allowance must be included in the gross income of the taxpayer and deduction taken in the proper manner in the return.

Manufacturing and Mining Business. — The gross income of a manufacturing or mining business is in general the same as that of a mercantile or merchandising business and consists of the total sales, less the costs of goods sold, plus any income from investments and from incidental or outside operations or sources. The income is arrived at in substantially the same manner as in the case of a mercantile business and in accordance with the methods prescribed in Forms 1040, Revised, and 1120. Finished and unfinished products and raw materials must be taken into consideration in the inventory in arriving at the gross income.

Miscellaneous Corporations.—The gross income of miscellaneous corporations consists of the total revenue derived from the operation and management of the business and property, to-

gether with all income from other sources. Corporations carrying on more than one class of business should include in their returns the gross income from all enterprises in which they are engaged.

Contracting Business.—Persons engaged in a contracting business, who have uncompleted contracts which may run for periods of several years may prepare their returns so that the gross income will be ascertained on the basis of completed work; that is, on jobs which have been finally completed, any amounts received in payment will be returned as income for the year in which the work was completed. If the gross income is ascertained in this way, the deductions should be limited to the expenditures made on account of such completed contracts. If he chooses, the taxpayer may estimate the percentage of profits from the contract on the basis of the percentage of completion, in which case the income returned each year during the performance of the contract will be computed upon the basis of the expenses incurred on the contract during the year. Thus, if one-half of the estimated expenses necessary to the full performance of the contract are incurred during one year, one-half of the gross contract price should be returned as income for that year. If, when the contract is completed, it is found that as a result of the estimate or apportionment, the income of any year has been overstated or understated, the taxpayer should file an amended return for such year or years.

Where a contractor enters into a contract during one year which will not be completed until the following year, and the contractor is required to make expenditures for material and labor, and to provide for possible losses, he may either include in gross income the advance payments received during the first year, or await the completion of the contract before reporting amounts received. If the second method is followed the expenses will not be charged until the completion of the contract.

Banks and Other Financial Institutions.—Gross income of banks and other financial institutions consists of the total revenue derived during the year from operation of the business, including gains or profits from the sale of capita assets and from all other sources.

Exporting Business.—A tax on the net income of an exporting business is not a tax laid on articles in the course of exportation or on anything which inherently or by the usages of commerce is

embraced in exportation or any of its processes, but is a tax on income levied after exportation is completed, after all expenses are paid and losses are adjusted, and after the recipient is free to use the income as he chooses, and such tax, therefore, is not unconstitutional. Accordingly, profits on all sales in foreign commerce are held to represent taxable income.

Income from Sales or Dealings in Property

All income from sales, exchanges, or other dealings in property is subject to tax and must be included in the return of the recipient for the year in which received. The rules for determining the amount of gain or loss derived from such transactions will be found under the caption "Basis for Determining Gain or Loss."

Sale of Shares of Stock.—When shares of stock in a corporation are sold from lots purchased at different times and at different prices, and the identity of the lots cannot be determined, the stock sold should be charged against the earliest purchases of such stock. Whenever possible the numbers of the certificates should be identified. The excess of the amount realized on the sale over the cost or the fair market value of the stock as of March 1, 1913, if acquired prior thereto, will be the profit to be accounted for as income. In the case of stock received as a stock dividend, whether or not paid out of earnings or profits accrued since February 28, 1913, and in the case of stock in respect of which any such dividend was paid, the cost of each share should be ascertained in accordance with the method described on page 61.

The entire amount realized from the sale of rights to subscribe for stock is income for the year in which such rights are sold.

Sale of Capital Stock by a Corporation.—The proceeds from the original sale by a corporation of its shares of capital stock, whether such proceeds are in excess of or less than the par value of the stock issued, constitute the capital and not the income of the company. If such stock is sold at a premium, the premium is not income. Likewise, if the stock is sold at a discount, the amount of the discount is not a deductible loss, no gain or loss being realized by the corporation from the purchase or sale of its own stock. If for any other purpose, stockholders donate or return to the corporation certain shares of the capital stock previously issued to them, and they are resold by it, or if the corporation purchases any of its

stock and holds it as treasury stock, the sale of such stock will be considered a capital transaction and the proceeds of the sale will be treated as capital and not as income of the corporation.

Sale of Capital Assets.—Where a corporation sells its capital assets in whole or in part, it must include in its gross income for the year in which the sale is consummated the amount of the excess of the sales price over the cost of the assets or their fair market value as of March 1, 1913, if acquired prior thereto. In every case, however, in ascertaining the gain or loss, the cost of the assets or the fair market value as of March 1, 1913, of the assets acquired prior thereto, should first be reduced by the amount of any charges for depreciation, depletion, and other losses which have been or should have been made. If the purchaser takes over the assets and assumes the liabilities the amount so assumed is part of the purchase price. If the sale is made for stock or bonds of another corporation the rules governing exchanges of property will apply.

Appreciation in the Value of Assets.—Appreciation in the value of assets due to appraisal or adjustment and taken up on the books of an individual or corporation is not income until as the result of a completed or closed transaction the assets are converted into cash or its equivalent. Such an appreciation is intangible and unstable, and is not such income as the law contemplates shall be returned for purposes of the tax.

Sale of Patents and Copyrights.—A taxpayer disposing of patents or copyrights by sale should determine the profit or loss arising therefrom by computing the difference between the selling price and the value as of March 1, 1913, if acquired prior to that date, or between the selling price and the cost, if acquired after that date. The profit or loss thus ascertained should be increased or decreased, as the case may be, by the amounts deducted on account of depreciation of such patent or copyright since February 28, 1913, or since the date of acquisition if subsequent thereto. If the patent was acquired from the Government, its cost will consist of the various Government fees, cost of drawings, experimental models, attorney's fees, etc., actually paid. If a corporation purchased a patent and paid for it in stock or securities, its cost is the fair market value of the stock or securities at the time of the purchase. Depreciation of a patent can be taken on the basis of the

fair market value as of March 1, 1913, only when affirmative and satisfactory evidence of such value is offered, which, whenever practicable, should be submitted with the return.

Sale of Good Will.—Profit or loss resulting from an investment in good will can be taken only when the business, or a part of it to which the good will attaches is sold, in which case the profit or loss will be determined upon the basis of the cost of the assets, including good will, or their fair market value as of March 1, 1913, if acquired prior thereto. If nothing was paid for good will acquired after February 28, 1913, no deductible loss is possible, although, on the other hand, upon the sale of the business there may be a profit. It is immaterial that good will may never have been carried on the books as an asset, but the burden of proof rests upon the taxpayer to establish the cost or fair market value on March 1, 1913, of the good will sold.

Sale and Retirement of Corporate Bonds.—If bonds are issued by a corporation at their face value, the corporation realizes no gain or loss. If the corporation later purchases and retires any of such bonds at a price in excess of the issuing price or face value, the excess of the purchase price over the issuing price or face value is a deductible expense for the taxable year. If, however, the corporation purchases and retires any of such bonds at a price less than the issuing price or face value, the excess of the issuing price or face value over the purchase price is gain or income for the taxable year.

If bonds are issued by a corporation at a premium, the net amount of such premium is gain or income which should be prorated or amortized over the life of the bonds. If thereafter the corporation purchases and retires any of such bonds at a price in excess of the issuing price, minus any amount of premium already returned as income, the excess of the purchase price over the issuing price, minus any amount of premium already returned as income (or over the face value, plus any amount of premium not yet returned as income) is a deductible expense for the taxable year. If, however, the corporation purchases and retires any of such bonds at a price less than the issuing price, minus any amount of premium already returned as income, the excess of the issuing price, minus any amount of premium already returned as income (or of the face value, plus any amount of premium not yet returned as income) over the purchase price is gain or income for the taxable year.

If bonds are issued by a corporation at a discount, the net amount of such discount is deductible as interest and should be prorated or amortized over the life of the bonds. If thereafter the corporation purchases and retires any of such bonds at a price in excess of the issuing price, plus any amount of discount already deducted, the excess of the purchase price over the issuing price, plus any amount of discount already deducted (or over the face value, minus any amount of discount not yet deducted) is a deductible expense for the taxable year. If, however, the corporation purchases and retires any of such bonds at a price less than the issuing price, plus any amount of discount already deducted, the excess of the issuing price, plus any amount of discount already deducted (or of the face value, minus any amount of discount not yet deducted) over the purchase price is gain or income for the taxable year.

Sale of Personal Property on Installment Plan.— Dealers in personal property ordinarily sell either for cash, or on the personal credit of the buyer, or on the installment plan. Occasionally, a fourth type of sale is met, in which the buyer makes an initial payment of such a substantial nature (for example, a payment of more than twenty-five per cent) that the sale, though involving deferred payments, is not one on the installment plan. In sales on personal credit, and in sales of the substantial payment type above referred to, obligations of the purchasers are to be regarded as the equivalent of cash, but a different rule is applicable to sales on the installment plan. Dealers in personal property, who sell on the installment plan, usually adopt one of four ways of protecting themselves in case of default:

(a) through an agreement that title is to remain in the seller until the buyer has completely performed his part of the transaction;

(b) by a form of contract in which title is conveyed to the purchaser immediately, but subject to a lien for the unpaid portion of the purchase price;

(c) by a present transfer of title to the purchaser, who at the same time executes a reconveyance in the form of a chattel mortgage to the seller; or

(d) by conveyance to a trustee pending performance of the contract and subject to its provisions.

The general purpose and effect is the same in all of the above plans, and the Department has ruled that in the sale or contract for sale of personal property on the installment plan, whether or not title remains in the vendor until the property is fully paid for,

the income to be returned by the vendor will be that proportion of each installment payment which the gross profit to be realized when the property is paid for bears to the gross contract price.

The income may be ascertained by taking that proportion of the total payments received in the taxable year from installment sales (always including payments received in the taxable year on account of sales effected in earlier years, as well as those effected in the taxable year) which the gross profit to be realized on the total installment sales made during the taxable year bears to the gross contract price of all such sales made during the taxable year. Where a change is made to this method of computing net income the taxpayer's balance sheet should be adjusted conformably as of the date when the change is effected. If for any reason the vendee defaults in any of his installment payments and the vendor repossesses the property, the entire amount received on installment payments, less the profit already returned, will be income of the vendor for the year in which the property was repossessed, and the property repossessed must be included in the inventory at its original cost to himself, less proper allowance for damage and use, if any. If the vendor chooses, as a matter of consistent practice, to treat the obligations of purchasers as the equivalent of cash, such method is permissible.

Where an installment house makes sales which are not on the installment plan, the profit on such completed sales is determined in the ordinary manner.*

Sale of Real Estate in Lots.—Where a tract of real estate is purchased with a view to dividing it into lots or parcels of ground to be sold as such, the entire fair market value as of March 1, 1913, or the cost if acquired after that date, must be equitably apportioned to the several lots or parcels and made a matter of record in the books of the taxpayer in order that any gain derived from the sale of any such lots or parcels may be returned as income for the year in which the sale was made. This rule contemplates that there will be a measure of gain or loss in every lot or parcel sold, and not that the capital invested in the entire tract shall be extinguished before any taxable income shall be returned. The sale of each lot or parcel will be treated as a separate transaction and the gain or loss will be accounted for accordingly.

Sale of Real Estate Involving Deferred Payments.—Deferred payment sales of real estate ordinarily fall into two classes when considered with respect to the terms of sale, as follows:

* See page 35.

(1) Installment transactions, in which the initial payment is relatively small (generally less than one-fourth of the purchase price) and the deferred payments usually numerous and of small amount. They include:

> (a) sales where there is immediate transfer of title when a small initial payment is made, the seller being protected by a mortgage or other lien as to deferred payments, and (b) agreements of purchase and sale which contemplate that a conveyance is not to be made at the outset, but only after all or a substantial portion of the installments have been paid.

(2) Deferred payment sales not on the installment plan, in which there is a substantial initial payment (ordinarily not less than one-fourth of the purchase price), deferred payments being secured by a mortgage or other lien. Such sales are distinguished from sales on the installment plan by the substantial character of the initial payment and also usually by a relatively small number of deferred payments.

In determining how these classes shall be treated in levying the income tax, the question in each case is whether the income to be reported for taxation shall be based only on amounts actually received in a taxing year, or on the entire consideration made up in part of agreements to pay in the future.

Sale of Real Estate on Installment Plan.—In the two kinds of transactions included in class (1) in the preceding paragraph, installment obligations assumed by the buyer are not ordinarily to be regarded as the equivalent of cash, and the vendor may report as his income from such transactions in any year that proportion of each payment actually received in that year which the gross profit to be realized when the property is paid for bears to the gross contract price. If the return is made on this basis and the vendor repossesses the property after default by the buyer, retaining the previous payments, the entire amount of such payments, less the profit previously returned, will be income to the vendor and will be so returned for the year in which the property was repossessed, and the property repossessed must be included in the inventory at its original cost to himself, less any depreciation. If the taxpayer chooses as a matter of settled practice consistently followed to treat the obligations of the purchaser as equivalent to cash and to report the profit derived from the entire consideration, cash and deferred payments, as income for the year when the sale is made, this is permissible. If so treated, the rule referred to in the next paragraph will apply.

Deferred Payment Sales of Real Estate Not on Installment Plan.—In class (2) in the second preceding paragraph the obligations assumed by the buyer are much better secured because of the margin afforded by the substantial first payment, and experience shows that the greater number of such sales are eventually carried out according to their terms. These obligations for deferred payments are therefore to be regarded as equivalent to cash, and the profit indicated by the entire consideration is taxable income for the year in which the initial payment was made and the obligations assumed. If the buyer defaults and the seller regains title to the land by agreement or process of law, retaining payments previously made, he may deduct from his gross income as a loss in the year of repossession any excess of the amount previously reported as income over the amount actually received, and must include such real estate in his inventory at its original cost to himself, less any depreciation allowed.

Income from Interest

All interest, including interest on bank deposits, accounts current, bonds, mortgages and other evidences of indebtedness, together with interest from miscellaneous sources, received by a taxpayer and not specifically exempt, must be reported as income for the year in which received, unless some other approved method of accounting is employed, permitting a return on an accrual basis.

Bond Interest.—All interest on bonds, notes, mortgages, or other interest-bearing obligations of residents, corporate or otherwise, must be included in the return of the recipient, even though the debtor corporation is specifically exempt from income tax. The fact that an interest coupon for any reason is not cashed when it matures, as before stated, does not relieve the recipient from the necessity of reporting the interest payment for the year in which due and payable, even though the coupons are later exchanged for other property instead of being cashed. If the coupons bear a date prior to March 1, 1913, but are not presented for payment until a later year, whether or not funds were on hand to meet them at maturity, they are not subject to tax, since they represent income due and payable and which could have been reduced to possession on demand prior to the incidence of the Federal income tax.

"Tax-free" Bonds.—The Department has ruled that the amount of income tax paid for a bondholder by an obligor or debtor

corporation, pursuant to a "tax-free" covenant in its bonds, is in the nature of additional interest paid such bondholder and must be included in his gross income.

Obligations of the United States.—Interest on obligations of the United States issued after September 1, 1917, is subject to surtax, and to war profits and excess profits taxes, except to the extent made exempt in the various Acts authorizing their issue.*

War Finance Corporation Bonds.—Interest on bonds issued by the War Finance Corporation is exempt from the individual normal tax and the corporation income tax, but is exempt from the surtax and war profits and excess profits taxes, only to the extent provided in the War Finance Corporation Act of April 5, 1918, namely, the income on a principal of $5,000 face value. Interest on the excess of that amount must be reported as income, being subject to surtax and war profits and excess profits taxes.

Railroad Administration Certificates and Food Administration Grain Corporation Notes.—The interest on United States Railroad Administration certificates, issued April 3, 1919, and the interest on Food Administration Grain Corporation notes are subject to Federal income and war profits and excess profits taxes.

Bonds Purchased Between Interest Dates.—Where bonds are purchased with accrued interest, the owner at the time the interest became due and payable should account in his return only for the interest which accrued after the bonds were purchased and not for the entire proceeds of the coupons. The former owner should account in his return for interest which accrued during his ownership of the bonds.

Bond Interest Received by Legatees.—A legatee should return as income the full amount of interest received by him on a bond, even though part of the first coupon payable after he received it has been added to the bond and included in the gross estate of the decedent, thereby becoming subject to the Federal Estate Tax Law.

Income from Rents and Royalties

Income from rents and royalties is subject to tax and must be included in the income tax return for the year in which received, unless the taxpayer's books are kept on some other approved basis.

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* See page 67.

All sums paid by a tenant for the use of property, even though to a person other than the landlord, are to be regarded as rent and constitute income of the landlord. Board, lodging or other consideration received in lieu of rental is considered income equal in amount to the indebtedness in payment of which it is received. Amounts expended by tenants for taxes and necessary repairs under agreement, in addition to a stipulated cash rental, must be included as income in the return of the landlord, who may deduct a corresponding amount as taxes paid or for repairs on rented property.

Permanent Improvements.—Where a tenant under the terms of a rental or lease contract agrees to erect a building or to expend during the period of his term a fixed sum in making improvements upon the freehold of another, the buildings or improvements are held to become a part of the realty unless otherwise agreed between the contracting parties, and accordingly must be returned as income by the lessor in the value of his realty at the termination of the contract, whether terminated by the expiration of the lease or otherwise. The lessor's gain at the termination of the lease will be the difference between the cost of the buildings or improvements and a reasonable allowance for exhaustion, wear and tear of the property, arising out of its use in the business or trade during the period of its life under the lease, no annual deduction for depreciation being allowed during the lease term. Since the use by the tenant during the term of the lease is a part of the consideration, the cost may be prorated by the tenant over the lease term and deducted at an annual rate as a part of the necessary expenses, together with the costs of incidental repairs and maintenance.

Royalties.—The term "royalties" includes all payments made to a proprietor by those whom he allows to develop or use his property or operate under some right belonging to him. Payments to an inventor for the use of his patent, or to an author as his share of the profits of a book, or to a mine owner for the privilege of developing and working his mineral property, all represent taxable income and as such must be included in the return of the recipient for the year in which received, unless properly accounted for as of a different period in accordance with some other approved method of accounting.

Royalties from Patent Rights.—Royalties received in accordance with a contract by which the owner of a patent assigns the right to manufacture machines are income to the recipient and are

to be accounted for as such. The owner of a patent may deduct from gross income each year, until the capital invested therein is extinguished, a sum ascertained by dividing the cost of the patent by the number of years constituting its life, or by a number representing the years of its life remaining after the date of acquirement. Where an inventor makes a contract whereby he agrees to sell to another the right to manufacture and dispose of a patented machine, in consideration of the payment of a stipulated sum for each machine sold, the amounts received by him represent taxable income. Where the entire rights are sold for a lump sum to a third party, his rights under the above contract being included, the difference between the lump sum so received and the aggregate amount expended by him in perfecting the invention and obtaining the patent are income for the year in which received.

Income from Dividends

The term "dividend" means any distribution in the ordinary course of business, even though extraordinary in amount, made by a domestic or foreign corporation, other than a personal service corporation, to its shareholders or members, whether in cash or in other property or in stock of the corporation, out of its earnings or profits accumulated since February 28, 1913, or any such distribution made by a personal service corporation out of its earnings or profits accumulated since February 28, 1913, and prior to January 1, 1918. Profits accumulated prior to March 1, 1913, are not included in the term "dividend" and should be excluded from the gross income of a taxpayer, since they are not subject to tax. A distribution out of assets other than earnings or profits accumulated since February 28, 1913, may or may not be free from tax, according as each stockholder receives more or less than he paid for his stock or its fair market value as of March 1, 1913, if acquired prior thereto. In determining whether a distribution is made out of earnings or profits accumulated before or after March 1, 1913, due consideration must be given to the facts in the case, and mere book entries increasing or decreasing the surplus of the corporation are not conclusive.

Taxable Status.—Dividends are income and are taxed for the year in which paid, namely, when set apart for a stockholder, regardless of when he collects them and regardless of when the earnings or profits out of which they were paid were accumulated by the corporation. Stock dividends are an exception to this rule.

Although interest on state or municipal bonds and certain other obligations is not taxable when received by a corporation, such income, upon amalgamation with other funds of the corporation, loses its identity and when distributed to stockholders in the form of dividends is taxable to the same extent as dividends from other sources.

Dividends of domestic or resident corporations, and dividends of foreign corporations paying a Federal income tax upon their net income, are subject to surtax only. The fact that the income of a foreign corporation derived from sources within the United States is small does not alter the situation, since if any income is derived from sources in this country, no matter how small, and tax is paid thereon, the dividends will be subject only to the surtax.

Dividends of nonresident foreign corporations, namely, those not paying any Federal income tax, are subject to both the normal tax and surtax when received by citizens or residents of the United States, but not when received by nonresident aliens; and this is true even though the dividends are paid by a disbursing agent of the nonresident corporation in the United States.

Dividends on Life Insurance Policies.—Dividends on life insurance policies that have not matured, whether paid in cash or added to the face value of the policy, are not items of taxable income, but dividends on paid-up policies are taxable income and subject to the surtax the same as any other dividends.

Liquidation Distributions.—So-called liquidating or dissolution dividends are not dividends within the meaning of the law, and amounts so distributed, whether or not including any surplus earned since February 28, 1913, are to be regarded as payments for the stock of the dissolved corporation. Any excess received over the cost of the stock to a stockholder, or over its fair market value as of March 1, 1913, if acquired before that date, is a taxable profit.

A distribution in liquidation of the assets and business of a corporation, which is a return to the stockholder of the value of his stock upon a surrender of his interest in the corporation, is distinguishable from a dividend paid by a going corporation out of current earnings or accumulated surplus when declared by the directors in their discretion, being is in the nature of a recurrent return upon the stock.

Distribution from Depletion or Depreciation Reserves.—A reserve set up out of gross income by a corporation and maintained for the purpose of making good any loss of capital

assets on account of depletion or depreciation, is not a part of its surplus out of which ordinary dividends may be paid. A distribution made from such a reserve will be considered a liquidating dividend and will be taxable to a stockholder only to the extent that the amount so received exceeds the cost or fair market value as of March 1, 1913, of his shares of stock. No distribution, however, will be deemed to have been made from such a reserve, except to the extent that the amount paid exceeds the surplus and undivided profits of the corporation.

Presumption as to Source of Distribution.—In the case of a corporation other than a personal service corporation, any distribution to stockholders is deemed to have been made, so far as possible

(a) from earnings or profits;
(b) during the year 1918 or thereafter, from earnings or profits accumulated since February 28, 1913;
(c) if during the first sixty days of a taxable year, from earnings or profits accumulated during preceding taxable years; and
(d) if during the remainder of a taxable year after the first sixty days, from earnings or profits accumulated during the taxable year up to the date of distribution.

If the books of the corporation do not show the amount of such earnings or profits, the earnings or profits for the accounting period within which the distribution was made is deemed to have been accumulated ratably during such period. The presumption contained in clauses (c) and (d) affects the determination of invested capital for the purpose of the war profits and excess profits tax, but has no effect upon the rates at which dividends paid in 1918 and subsequent years are taxed. In ascertaining whether or not a distribution was made out of earnings or profits of the taxable year there should first be set aside a proper reserve for the payment of accrued income and war profits and excess profits taxes.

In the case of a personal service corporation any distribution is deemed to have been made so far as possible

(a) from earnings or profits;
(b) during the year 1918 or thereafter, from earnings or profits accumulated since February 28, 1913.
(c) if during the first sixty days of a taxable year, from the most recently accumulated earnings or profits of preceding taxable years and
(d) if during the remainder of the taxable year after the first sixty days, from earnings or profits accumulated during the taxable year up to the date of distribution.

Dividends Paid in Securities or Other Property.—Dividends paid in securities or other property, other than its own stock, in which the earnings of a corporation have been invested, are income to the recipient to the amount of the fair market value of such property when received by the stockholders.

Scrip Dividends.—Scrip certificates issued to a corporation's stockholders, in lieu of dividends, bearing interest and redeemable within one year, are not corporate obligations similar to bonds, mortgages or deeds of trust. Payment in scrip is held to be equivalent to payment in cash, and such dividends should be included in the return of the recipient for the year in which the warrants are issued at the face value of the scrip, the transaction being regarded as a payment in cash of the dividends and an investment of the cash in scrip.

Stock Dividends.—The term "stock dividend" means a distribution by a corporation to its stockholders of the capital stock of the distributing corporation. Such a dividend is income to the amount of the earnings or profits distributed, as shown by the transfer of surplus to capital account on the books of the corporation, usually equal to the par value of the stock distributed. Stock distributions made out of surplus other than earnings or profits accumulated since February 28, 1913, when there are no such earnings or profits, are not dividends within the meaning of the statute and are free from tax. Stock dividends paid from earnings or profits accumulated after February 28, 1913, received by a fiduciary and retained as an accretion to the estate under the terms of the will or trust, are income to the estate or trust.

The question of the taxable status of stock dividends under the 1916 law is raised in the case of Macomber vs. Eisner, now pending in the Supreme Court of the United States. Inasmuch as stock dividends are expressly made subject to tax under the 1916, 1917 and 1918 laws, the language being similar in that respect, the decision will affect their taxable status under each Act.

Stock Dividends of 1918 and 1919.—By a special exception to the general rule any stock dividend received by a taxpayer between January 1 and November 1, 1918, or declared and credited to a stockholder during such period and received by him before March 27, 1919, is deemed to have been paid from the most recently accumulated earnings or profits and taxed to the recipient at the rates prescribed for the years in which the corporation accumulated

the earnings or profits so distributed. Thus, such a stock dividend will be deemed to have been paid from the earnings of 1918 (unless paid during the first sixty days of 1918, in which case it will be deemed to have been paid from earnings accumulated during preceding taxable years), and the recipient, if an individual, will be liable to any surtax at the rates for the year 1918, unless at the time such dividend was paid or credited the current earnings up to that time were not sufficient to cover the distribution, in which case the excess over the earnings of the taxable year will be deemed to have been paid from the most recently accumulated surplus of prior years and will be taxed at the rate or rates for the year or years in which earned. A distribution made after the first sixty days of a taxable year is deemed to have been made from earnings accumulated between the close of the preceding year and the date of distribution to the extent of such earnings. A corporation declaring and paying such a stock dividend out of earnings accumulated over a period of years should make a record in its books of the amount of the dividend paid out of each year's undistributed profits and advise the stockholders accordingly.

Sale of Stock Received as Dividend.—As stock dividends were taxable income under the Revenue Act of 1916*, as well as under the present statute, but were not under the Act of October 3, 1913, different considerations may apply to the sale of stock received as a dividend before 1916 and stock so received thereafter. For the purpose of ascertaining the gain or loss derived from the sale of stock of a corporation received as a dividend, or from the sale of the stock in respect of which such dividend was paid, the cost, or if acquired before March 1, 1913, the fair market price or value as of that date of such stock, is to be determined in accordance with the following rules:

(1) In the case of stock (a) received as a dividend in 1913, 1914 or 1915 out of surplus however created, or (b) received as a dividend in 1916 or subsequent years out of surplus other than earnings or profits accumulated since February 28, 1913, the cost of each share of new stock is the quotient of the cost of the old stock divided by the number of old and new shares added together.

(2) In the case of the stock in respect of which any stock dividend was paid as described under (1), the cost of each share of old stock is similarly the quotient of the cost of the old stock divided by the number of old and new shares.

(3) In the case of stock received as a dividend in 1916 or subsequent years out of earnings or profits accumulated since February 28,

*See page 60.

1913, the cost of each share of new stock is the quotient of the sum of (a) the cost of the old stock plus (b) the valuation at which the new stock was returnable as income (as shown by the transfer of surplus to capital account on the books of the corporation, usually its par value), divided by the number of old and new shares added together.

(4) In the case of the stock in respect of which any stock dividend was paid as described under (3), the cost of each share of old stock is similarly the quotient of the sum of (a) the cost of the old stock plus (b) the valuation at which the new stock was returnable as income, divided by the number of old and new shares.

Stock dividends declared from surplus created by the revaluation of capital assets or by placing a value on trademarks, good will, etc., do not represent a distribution of earnings or profits subject to tax as a dividend in the hands of the stockholder receiving the same. When stock received in payment of such a dividend, or stock in respect of which any such dividend was paid is sold, the cost of each share of stock whether old or new, for the purpose of ascertaining the gain or loss resulting from its sale, is the quotient of the cost of the old stock, if acquired on or after March 1, 1913, or its fair market value as of that date if acquired prior thereto, divided by the number of old and new shares added together. The profit so ascertained from a sale is income subject to both normal tax and surtax and must be returned as such for the year in which the sale is made.

Miscellaneous Income

Income from miscellaneous sources includes all those items of income which cannot conveniently be grouped under any other one head. All such income must be included in the taxpayer's return for the year in which received.

Interest in Partnership or Personal Service Corporation.—The net distributive share of a taxpayer in the earnings of a partnership of which he is a member, or of a personal service corporation in which he is a stockholder, whether such earnings are distributed or not, must be reported by such partner or stockholder as income and will be subject to tax in his hands. The proportionate share of each stockholder or partner in dividends, interest on obligations of the United States subject to tax, and taxable interest on War Finance Corporation bonds received by the partnership or personal service corporation must be included in the individual returns of the partners or stockholders for purposes of the surtax. Earnings of a personal service corporation

accumulated prior to January 1, 1918, are not treated in the manner above described, but when distributed are regarded as corporate dividends, and as such are subject only to the surtax.

Recovery of Bad Debts.—Bad debts or accounts claimed and allowed as deductions in prior returns are considered income if subsequently collected, and should be included as such in the return of the taxpayer for the year during which recovery is had. Neither the date at which the bad debt was charged off nor the fact that it was or was not deducted from gross income in any return will affect its character as income for the year in which recovery is had.

Forgiveness of Indebtedness.—The cancellation of indebtedness is dependent upon the circumstances for its effect. It may amount to a payment of income, or to a gift, or to a capital transaction. If, for example, an individual performs services for a creditor, who, in consideration for such services, cancels the debt, income to that amount is realized by the debtor as compensation for his services. If, on the other hand, a creditor, merely desiring to benefit a debtor and without any consideration therefor, cancels the debt, the amount thereof is a gift and need not be included by the debtor in his return. If a stockholder in a corporation which is indebted to him gratuitously forgives the debt, the transaction amounts to a contribution to the capital of the corporation. If a corporation to which a stockholder is indebted forgives his debt, the transaction has the effect the of payment of a dividend.

Contributions by Stockholders.—Where a corporation needs additional funds for the conduct of its business and obtains such needed money through voluntary pro rata payments by its stockholders, the amounts thus received being credited to its surplus account, or to a special capital account, such amounts will not be considered income even though there is no increase in the outstanding shares of the corporation's stock. Such payments are regarded as in the nature of voluntary assessments upon and as representing an additional price paid for their shares of stock by the individual stockholders and will be treated as an addition to and as part of the operating capital of the corporation.

Compensation for Loss.—In the case of property lost or destroyed in whole or in part, through fire, storm, shipwreck, or other casualty, or where the owner of property has lost or transferred title by reason of the exercise of the power of requisition or eminent domain, including cases in which a voluntary transfer

or conveyance is induced by reason of the fact that a technical requisition and condemnation proceeding is imminent, the amount received by the owner as compensation for the property may show an excess over the value of such property on March 1, 1913, or over its cost if acquired after that date, (after making proper provision for depreciation to the date of the loss, damage, or transfer). The transaction is not regarded as completed at this stage if the taxpayer proceeds immediately in good faith to replace the property, or if he makes application to establish a replacement fund. In such a case, the gain, if any, is measured by the excess of the amount received over the amount actually and reasonably expended in replacing or restoring the property substantially in kind, exclusive of expenditures for additions or betterments. The new or restored property effects a replacement in kind only to the extent that it serves the same purpose as the property which it replaces without added capacity or other elements of additional value.

The new or restored property must not be valued in the taxpayer's accounts at an amount exceeding the cost or the value as of March 1, 1913, if acquired prior thereto (after making proper provision for depreciation to the date of the loss, damage, or transfer) of the original property, plus the cost of any actual additions and betterments. If the taxpayer does not elect to replace or restore the property, the transaction will then be deemed completed, the income being measured by the excess of the amount of the compensation received over the cost of the property or its actual value on March 1, 1913, if acquired prior thereto (after making proper provision for depreciation to the date of the loss, damage, or transfer). These provisions have no application to property which is voluntarily sold or disposed of.

Replacement Fund for Loss.—Where a taxpayer elects to replace or restore the lost, damaged, or transferred property, but where it is not practicable to do so immediately, he may obtain permission to establish a replacement fund in his accounts in which the entire amount of the compensation so received shall be held without deduction for the payment of any mortgage, and pending the disposition thereof, the accounting for gain or loss thereupon may be deferred for a reasonable period of time. The allowance of a replacement fund for loss, as stated in the preceeding paragraph, does not apply to property voluntarily sold or disposed of. In such a case the taxpayer should apply to the Commissioner on

Form 1114 for permission to establish a replacement fund, reciting in the application all facts relating to the transaction and undertaking that he will proceed as expeditiously as possible to replace or restore such property.

A bond must be furnished with such surety as the Commissioner may require for an amount not less than the estimated additional income and war profits and excess profits taxes assessable upon the income so carried to the replacement fund. The estimated additional taxes for the amount of which the claimant is required to furnish security should be computed at the rates at which the claimant would have been obliged to pay, taking into consideration the remainder of his net income and resolving against him all matters and disputes affecting the amount of the tax. Only surety companies holding certificates of authority from the Secretary of the Treasury as acceptable sureties on Federal bonds will be approved as sureties. The application should be executed in triplicate so that the Commissioner, the applicant, and the surety or depositary may each have a copy.

Annuities.—All income from annuities is subject to tax, even though paid by religious, charitable, educational, or other exempt corporations, to the extent that the aggregate amount of the payments to the annuitant exceeds any amounts paid by him as consideration for the contract. An annuity charged upon devised land is taxable income to the annuitant, whether paid by the devisee out of the rents of the land or from other sources. The devisee is not required to return as taxable income the amount of rent paid to the annuitant nor is he entitled to deduct from his taxable income any sums paid to the annuitant.

EXEMPT INCOME

There are certain items of income which are expressly excluded from the gross income of a taxpayer, and which are exempt from tax whether the recipient is a citizen or resident of the United States or a nonresident alien with respect to the United States. Such income need not be included in the taxpayer's return unless information regarding it is called for, as in the case of interest on municipal bonds, interest on Federal Farm Loan bonds, etc.

Proceeds of Insurance and Damages for Injury.—Upon the death of an insured, the proceeds of his life insurance policies, whether paid to his estate or to individual beneficiaries, directly, or in trust, are excluded from the gross income of the

beneficiary. During his life, only so much of the amount received by an insured under life, endowment or annuity contracts as represent a return, without interest, of premiums paid by him therefor, is excluded from his gross income. Whether he is alive or dead, the amounts received by an insured or his estate or other beneficiaries through accident or health insurance or under workmen's compensation acts as compensation for personal injuries or sickness are excluded from the gross income of the insured, his estate, and other beneficiaries. Any damages recovered by suit or agreement on account of such injuries or sickness are similarly excluded from gross income of the individual injured, if living, or of his estate or other beneficiaries entitled to receive such damages, if dead. Since June 25, 1918, no assessment of any Federal tax may be made on any allotments, family allowances, compensation, or death or disability insurance paid under the War Risk Insurance Act of September 2, 1917, as amended, even though the benefit accrued before that date.

Gifts and Bequests.— Money and real or personal property, received as gifts or received under a will or under statutes of descent and distribution, are exempt from tax, but the income therefrom derived from investment, sale, or otherwise, is taxable. An amount of principal paid under a marriage settlement is a gift. Alimony or allowances based on a separation agreement do not represent taxable income.

Interest upon State and Other Obligations.—Interest upon the obligations of a state, territory or any political subdivision thereof, or the District of Columbia, is exempt from tax. Obligations issued for a public purpose by or on behalf of a state or territory or a duly organized political subdivision, acting by constituted authorities duly empowered to issue such obligations are the obligations of a state or territory or a political subdivision thereof. The term "political subdivision" means any division of the state or territory made by the proper authorities acting within their constitutional powers for the purpose of carrying out a portion of those functions of the state or territory which by long usage and inherent necessities of government have always been regarded as public. The term includes special assessment districts so created, such as road, water, sewer, gas, light, reclamation, drainage, irrigation, levee, school, harbor, port improvement, and similar districts or divisions of a state or territory. The purchase by a state of property subject to a mortgage executed to secure an issue

of bonds does not render the bonds obligations of the state so as to exempt the interest therefrom, whether or not the state assumes the payment of the bonds.

Dividends Paid by a Federal Reserve Bank.—The income derived from dividends on the stock of Federal reserve banks in the hands of the stockholders is exempt from income tax, but dividends paid by member banks are not exempt. The dividends on stock of Federal land banks and national farm loan associations and interest on farm loan bonds is exempt from tax.

Interest upon United States Obligations.—Although interest upon obligations of the United States is in general exempt from tax, in the case of obligations issued after September 1, 1917, including Treasury certificates of indebtedness, war savings certificates and the various Liberty bond issues (except the first Liberty Loan 3½% bonds and the 3¾% Victory notes) the interest is exempt from tax only if and to the extent provided in the acts authorizing the issue thereof, as amended and supplemented. Interest on all obligations of the United States issued after September 1, 1917, is exempt from the normal tax and the corporation income tax, but is subject to the surtax and to the war profits and excess profits taxes, except as otherwise provided in the various acts authorizing the issue of such obligations. Interest from the following maximum amounts of principal is exempt from all income and war profits and excess profits taxes. Income in excess of the maximum exemption is subject to surtax, and war profits and excess profits taxes. Form 1125 should be secured and taxable interest computed if United States obligations issued after September 1, 1917, are held in excess of the exemptions specified below.

Exempt for Life of Bonds.

3½% 3¾%	..............................Holdings unlimited
4 % 4¼%	..........................Aggregate Holdings of $5,000

Exempt for Five Years After Declaration of Peace.

4 % 4¼%	..........................Aggregate Holdings $30,000[1]

(1) Additional granted by act March 3, 1919, irrespective of subscription to Victory Loan.

Exempt for Two Years After Declaration of Peace.

1st 4¼%, issue of Oct. 24, 1918, only..................	$30,000
4th 4¼%...	$30,000

Conditional Exemptions.

4 % 2nd 4¼% 3rd 4¼%	....................Aggregate Holdings of $45,000[2]
4 % 4¼%	................................Additional $20,000[3]

(2) For 2 years after declaration of peace, provided original subscription was made to $30,000 Fourth Loan and still owned at the date of the taxpayer's income tax return. If less than this amount, then the exemption is equivalent to 1½ times the amount so subscribed and held.

(3) Provided original subscription is made for $6,700 Victory Liberty Loan of 1923 and the notes are still owned at the date of the taxpayer's income tax return. If less than this amount is subscribed for, then the exemption is equivalent to three times the amount so subscribed and held.

Total possible exemptions on all loans $160,000.

All interest on 4¾% Victory Notes is subject to surtax and war profits and excess profits taxes.

Exemption of Liberty Bonds in the Case of Trusts.—When income is taxable to beneficiaries, as where the income of a trust is to be distributed to the beneficiaries periodically, each beneficiary is regarded as the owner of a proportionate part of the bonds held in trust and is entitled to exemption on account of such ownership as if he owned a proportionate part of the bonds directly. In such case a subscription by a trustee for bonds of the Fourth Liberty Loan or the Victory Loan, for example, constitutes each beneficiary existing at the time of such subscription an original subscriber for his proportionate part of such bonds or notes as the case may be, and entitles him to the appropriate collateral exemption of interest on bonds of previous issues, whether owned by the beneficiary or by the trustee, as though the beneficiary had himself originally subscribed for such proportionate part of the bonds or notes. A subscription of such beneficiary for bonds of the Fourth Loan or notes of the Victory Loan, as the case may be, entitles him to the appropriate collateral exemption of interest on bonds of previous issues held by the trustee.

When, however, income is taxable to the trustee, as in the case of a trust, the income of which is accumulated for the benefit of unborn or unascertained persons, the trustee is regarded as the owner of all the bonds held in trust and is entitled to exemption on account of such ownership. In such a case a subscription by the trustee constitutes the trustee as such an original subscriber and entitles him to the collateral exemption on interest on bonds of previous issues.

Exemption in the Case of Partnerships and Personal Service Corporations. — Since the income of a partnership is taxable to the individual partners, each partner is treated as the owner of a proportionate part of the bonds held by the partnership and is entitled to exemption on account of such ownership, as if such partner owned such proportionate part of the bonds directly. Such partner, if a partner at the time of the original subscription by the partnership for bonds of the Fourth Liberty Loan, or notes of the Victory Loan, as the case may be, is treated as an original subscriber for his proportionate part of such bonds or notes subscribed for by the partnership and is entitled to the appropriate collateral exemption of interest on bonds of previous issues on account of such original subscription for bonds or notes as if he had subscribed directly for such proportionate part. The same principle applies to stockholders in personal service corporations.

Income of Foreign Governments and Their Officers.—Income of foreign governments received from sources within the United States is exempt from tax, the exemption applying to political subdivisions of foreign governments. Any income collected by a foreign government from investments in the United States in stocks, bonds or other domestic securities which are not actually owned by, but are loaned to such foreign governments is subject to tax. Income of foreign ambassadors and ministers from investments in bonds and stocks and from interest on bank balances, and the fees of foreign consuls are exempt from tax, but income of such foreign officials from any business carried on by them in the United States is taxable. The compensation of citizens of the United States who are officers or employees of a foreign government is not exempt from tax.

Income of States.—Income accruing to any state, territory, or possession of the United States, or to any political subdivision thereof, or to the District of Columbia, is exempt from tax. The income of state workmen's compensation insurance funds established by state statutes is not taxable. In the case of a public utility, acquired, constructed, operated, or maintained by a taxpayer under contract with any state, territory, or political subdivision thereof, or with the District of Columbia, containing an agreement that a portion of the net earnings of such public utility shall be paid to the state, territory, or political subdivision thereof,

or the District of Columbia, the amount so paid may be deducted by the taxpayer as a necessary expense in transacting business.

Compensation of State Officers.—Compensation paid to officers or employees by a state or political subdivision thereof, including fees received by notaries public commissioned by states, and the commissions of receivers appointed by state courts are not taxable. Employees of universities receiving salaries paid in part or in whole from funds available under the Smith-Lever Act of May 8, 1914, who are officers or employees of a state are not required to return as taxable income the salaries so received. This is true with respect to the Act of August 30, 1890, relating to colleges for the benefit of agriculture and the mechanic arts, and the Act of March 2, 1887, relating to agricultural experiment stations in such colleges.

Compensation of Soldiers and Sailors.—A person of either sex in the active service of the military or naval forces of the United States may exclude from gross income any compensation from the United States up to the amount of $3,500 in any taxable year, but this exemption does not apply to compensation received before or after the present war, the date of the termination of the war to be fixed by the proclamation of the President. The term "military and naval forces of the United States" includes, among other things, the marine corps, the coast guard, the army nurses corps, female, and the navy nurses corps, female, and also army contract surgeons. A person is in active service if he is actually serving in such forces and is not merely on the retired or reserve list. He need not necessarily serve in the field or in the theatre of war. If such a person receives compensation from the United States of $3,500 or less and has no other income of an amount sufficient in itself to require him to render a return he need not make one. Members of draft boards are not as such entitled to this exemption.

Income Accruing Prior to March 1, 1913.—Property held by the taxpayer on March 1, 1913, represents capital. Included in such capital are claims, whether evidenced by writing or not, and all interest accrued before that date. Interest accruing on or after that date is taxable. Where an interest-bearing claim contracted before March 1, 1913, is paid in whole or in part after that date any gain derived from the conversion of the claim into money is taxable. The amount of gain is the excess of the proceeds of the claim, both principal and interest, exclusive of any interest

accrued since February 28, 1913, already returned as income, over the fair market value of the claim as of March 1, 1913 (both principal and interest then accrued). In the case of an insurance policy, its surrender value as of March 1, 1913, may be used as a basis for the purpose of determining the gain derived from the sale or other disposition of such policy. Where services were rendered prior to March 1, 1913, but paid for thereafter, the amount received is taxable income to the extent of the excess of such amount over the fair market value on March 1, 1913, of the principal of the claim and any interest which had then accrued. A claim means a right existing unconditionally on March 1, 1913, and then assignable, whether presently payable or not. Interest does not, of course, include dividends on corporate stock.

DEDUCTIONS

In General

Important changes were made in the Act of 1918 in regard to deductions for both corporations and individuals, the principal of which were the addition of deductions for amortization of facilities constructed for war purposes, and for shrinkage in inventories and for rebates in 1919 made in pursuance of contracts entered into during 1918 upon sales made during such year. Other changes permit the full deduction of interest by corporations, except interest on indebtedness incurred or continued to purchase or carry tax-exempt securities; deductions by individuals of all losses in transactions entered into for profit but not connected with the trade or business; deduction for obsolescence; deduction by corporations of dividends received from corporations subject to income tax; and deduction for taxes accrued as well as paid. With certain exceptions, the deductions allowed individuals and corporations are the same.

Manner and Time of Making Deductions.—Deductions may be made either on a cash or on an accrual basis, depending upon the manner in which the taxpayer keeps his books, the accrual basis being used only when such basis is used in the determination of gross income. With the exception of the deduction of net losses, as provided under Section 204, the return of the taxpayer shall include only the deductions which pertain to the year in which the return is made. Thus, deductions of whatever character against income cannot be cumulative, but must be taken in the year in which such expenses or other allowances are paid or accrued.

If, however, the taxpayer discovers that he has omitted a deduction in a preceding year, his return for such year may be amended, and the deduction included.

Items Not Deductible.—The following items are not allowed as deductions:

(a) Personal, living, or family expenses;

(b) Expenditures for new buildings or for permanent improvements or betterments made to increase the value of the property or estate;

(c) Expenditures for restoring property or in making good the exhaustion thereof for which allowance has been taken;

(d) Premiums on any life insurance policy covering the life of any officer or employee, or of any person financially interested in the business of the taxpayer whenever the taxpayer is directly or indirectly a beneficiary under such policy.

Personal and Family Expenses.—The following items are included in personal expenses and are not deductible:

(a) Insurance premiums paid covering a dwelling occupied by the taxpayer;

(b) Premiums paid for life insurance by the insured;

(c) The cost of equipment of an army officer, except to the extent that it is required by his profession, and does not merely take the place of articles required in civilian life;

(d) Commuter's carfare between home and office and amounts expended for luncheon.

Where a professional man uses part of his house for his office, only the portion of the rent properly attributable to his office is deductible.

Restoration of Property.—If an allowance is claimed for depreciation of property, the expense of restoring such property may not again be deducted as an item of expense or in any other manner. Repairs in the nature of replacements to the extent that they arrest deterioration and appreciably prolong the life of the property should be charged against depreciation reserve. Incidental repairs which do not add to the value of the property nor appreciably prolong its life are deductible. Small items, such as replacement of broken window panes, papering, and minor repairs, are allowable deductions, even though the full amount of depreciation has been claimed.

Inasmuch as amounts expended for betterments are deemed to be an addition to capital, such amounts are not deductible from income. If such expenditures, however, constitute a capital investment, they may be extinguished through a proper allowance for depreciation and obsolescence.

Premiums on Life Insurance of Employees of Corporations.—The 1918 law specifically provides that a taxpayer cannot deduct premiums paid on an insurance policy on the life of an employee or individual financially interested in the taxpayer's business for the purpose of protection against loss in the event of the death of such person. The proceeds of such insurance paid upon the death of the insured to a corporate beneficiary, less any amounts paid as premiums, must be included in gross income.

Expenses in Trade or Business

Deductions are permitted of all ordinary and necessary expenses paid or incurred during the taxable year in carrying on an trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered, and including rentals or other payments required to be made as a condition to the continued use or possession of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

Business Expenses.—Business expenses, whether subtracted from total receipts in computing gross income or deducted from gross income in computing net income, include all items entering into what is ordinarily known as the cost of goods sold, together with selling and management expenses, except such classes of deductions as are segregated under heads other than business expenses. Among the items to be treated as business expenses are material, labor, supplies, and repairs in the case of a manufacturer, while a merchant would include his purchases of goods bought for resale. In either case, the amount to be taken as a deduction in any year should be determined by taking into consideration the inventory at the beginning and end of the year. Other items that may be included as business expenses are reasonable compensation for the services of officers and employees, advertising and other selling expenses, together with insurance premiums against fire, storm, theft, accident and other similar losses in the case of a business, and rental for the use of business property. A taxpayer is entitled

to deduct the necessary expenses paid in carrying on his business from his gross income from whatever source derived.

A manufacturing corporation may include as an element of the cost of manufactured products, the cost of raw material, the cost of labor of the men who actually work on such products, as well as the cost of supervisory, or what may be denominated as "unproductive" labor, such as that of foremen, inspectors, overseers, etc., provided such expenditures are not separately deducted from gross income in the return of annual net income.

Taxpayers carrying materials and supplies on hand should include in expenses the charges for materials and supplies only to the extent that they are actually consumed and used in operation during the year for which the return is made, provided that the cost of such material and supplies has not been taken into account in determining the net income for any previous year. If a taxpayer carries materials or supplies on hand for which no record of consumption is kept or of which physical inventories at the beginning and end of the year are not taken, it will be permissible for the taxpayer to include in his expenses and deduct from gross income the total cost of such supplies and materials as were purchased during the year for which the return is made, provided the net income is clearly reflected by this method. Expenditures which are taken into account in determining the cost of products, finished or unfinished, are not to be again deducted as expenses of operation and maintenance.

Capital Expenditures.—Confusion often arises in regard to the status of certain capital charges which cannot be deducted as expenses. Thus, organization expenses of a corporation, including fees of attorneys and accountants and those paid to the state for the charter, are considered capital investments, and are not deductible. Other capital expenditures not deductible include amounts paid which add to the cost of an investment; commissions paid in purchasing and selling securities; assessments made under mutual agreement between bondholders and stockholders to be used in the reorganization of a corporation or otherwise made by a corporation upon its stockholders; expenditures for improvements and betterments; amounts paid for securing copyrights and plates which remain in the possession of and as property of the person making the payments; cost of defending title or protecting title to property; sums expended for architects' services in construction of plants or buildings.

Professional Expenses.—A professional man may claim as deductions, the cost of supplies used by him in his profession and all expenses incidental to his work, including rent, fuel, light, telephone, etc., but cannot deduct amounts paid for books, furniture and professional instruments and equipment of a permanent character.

Depositors' Guaranty Fund.—Banking corporations, which, pursuant to the laws of the state in which they are doing business, are required to set aside a fund, generally known as a depositors' guaranty fund, may deduct the amount so set aside, if the amount ceases to be an asset of the bank and may be withdrawn by a state officer for the purpose of reimbursing depositors in insolvent banks, and if no portion of the amount credited is returnable to the banking corporation.

Compensation for Services.—Compensation for personal services, deductible as an expense of the business, must represent reasonable compensation for the purchase of services. Payments nominally made as compensation for services, which in fact include amounts paid as dividends, and payments for property or for anything other than services, are deductible only to the extent that they are not in excess of compensation paid for like services in similar enterprises.

Pensions to retired employees, or to their families, or others dependent upon them, or on account of injuries received by employees and lump sum amounts paid as compensation for injuries are proper deductions as necessary expenses, but only to the extent that they are not compensated for by insurance or otherwise. If the amount of the salary of an officer or employee is paid for a limited period after his death to his widow or heirs, in recognition of the services rendered by the individual, such payments may be deducted.*

Salaries paid by employers during the war to employees who are absent in the military or naval service, or who are serving the Government in other ways, at a nominal compensation, are allowable deductions.

Bonuses.—Gifts or bonuses to employees constitute allowable deductions from gross income when such payments are made in good faith and as additional compensation for services actually rendered by the employees, provided that such payments, when

*See page 45.

added to the stipulated salaries, do not exceed a reasonable compensation for the services rendered. Donations made to employees which do not have in them an element of compensation for services are considered gratuities and are not deductible from gross income. This rule applies whether the bonus is a fixed sum or whether paid on a profit-sharing basis, the only condition being that the amount paid the employee is for services rendered and is reasonable.

Allowances to Minor Child.—As a rule, allowances given to a minor child by the parent, whether said to be in consideration of services or otherwise, are not allowable deductions in the return of income, nor are they income to the children. If however, a child has obtained his or her majority, the amount of compensation paid for service may be claimed as a deduction.

Commissions Paid to Salesmen and Agents.—Commissions paid to salesmen as part of the expense of conducting the business, are allowable deductions, whether paid in cash, stock, or other property. Likewise, commissions paid to real estate agents for collecting rents, and managing property, are legitimate business expenses and may be deducted.

Amounts paid out for expenses necessary and incidental to service rendered in earning a salary are deductible. For instance, if an agent receives a salary of $5,000 a year, but in order to transact business, he is required to rent an office and pay clerk hire amounting to $1,000 a year, he would be allowed to deduct as a business expense, the $1,000 paid out. Likewise, if he is required to furnish bond and pay a premium on such bond as a necessary incident of his employment, the premium of the bond would constitute an allowable deduction.

Traveling Expenses.—The Department has held that if an individual is required to travel in connection with his business, the railroad fares are business expenses, but meals and lodging are living expenses and not deductible. If, however, such an individual receives a salary and is also repaid his actual traveling expenses, no part of such traveling expenses repaid should be included in gross income, and therefore no deduction should be made on account of such expenses. If he receives a salary with an allowance for meals and lodging, any excess of the cost of such meals and lodging, over the allowance is not deductible, but any excess of the allowance over the actual expense is taxable income.

Spending Money.—Spending money actually advanced by employers to traveling salesmen or others to be used by them as part of the expense incident to the transaction of business, is an allowable deduction if shown to be an ordinary and usual expense incurred in such business.

Redemption of Trading Stamps.—If a taxpayer issues with sales trading stamps or premium coupons, redeemable in merchandise or cash, he should, in computing net income from such sales, subtract only the amount received or receivable, based on the experience of the taxpayer or other users engaged in similar business, which will be required for the redemption of such part of the total issue of trading stamps or premium coupons issued during the taxable year as will eventually be presented for redemption. The taxpayer shall file for each of the five preceding years or such number of these years as stamps or coupons have been issued by him, a statement showing (a) the total issue of stamps during each year, (b) the total stamps redeemed in each year, and (c) the percentage in each year of the stamps redeemed to the stamps issued in such year. The Commissioner will examine the basis used in each return and in any case in which the amount subtracted in respect of such stamps or coupons is found to be excessive, an amended return will be required.

Expenses of Rented Property.—Expenses of rented property, including amounts paid for repairs, insurance, fuel, light and water, janitor and elevator service, and an amount representing a reasonable allowance for wear and tear and obsolescence of the property arising from its use for rental purposes, may be deducted. Insurance premiums paid in advance on rented property, covering a period of several years may be deducted in full at the time of payment if the taxpayer's books are kept on a cash basis. If the taxpayer's books are kept on an accrual basis, the premium should be prorated over the period covered by the insurance. Funds set aside by a corporation for insuring its own property are not deductible, but any loss actually sustained and charged to such funds may be deducted when the loss is sustained.

Interest

The law permits the deduction of all interest paid or accrued within the taxable year on indebtedness, or in case of a nonresident alien or foreign corporation, the proportion of such interest paid or accrued which the amount of gross income from sources within the

United States bears to the amount of gross income from all sources within and without the United States; but interest on indebtedness incurred or continued to purchase or carry obligations or securities (other than obligations of the United States issued after September 24, 1917), the interest upon which is wholly exempt from income tax, is not deductible.

The use of the word "accrued" in the 1919 law should not be construed to mean that accrued interest is deductible in all cases, deduction on an accrual basis being dependent upon the taxpayer keeping his accounts on an accrual basis which clearly reflects his income. In other words, only interest actually paid is deductible, unless the requirements of the law for making return on an accrual basis are complied with.

Interest paid on bank deposits, and interest paid on indebtedness incurred or continued to purchase or to carry a dividend-paying stock, is deductible. So-called interest on preferred stock, however, which is in reality a dividend cannot be deducted. Interest on capital invested in the business but which does not represent a payment on interest-bearing obligations is not an allowable deduction from gross income.

Taxes

Deductions may be made for taxes paid or accrued within the taxable year imposed as follows:

(a) By the authority of the United States, except income, war profits and excess profits taxes;

(b) By authority of any of its possessions, except income, war profits and excess profits taxes paid during the taxable year which are allowed as credits against the tax;

(c) By authority of any state or territory or any subdivision thereof, exclusive of those assessed against local benefits;

(d) In the case of a citizen or resident of the United States, by authority of any foreign country, except the amount of income, war profits and excess profits taxes paid to such foreign country, which is allowed as a credit against the tax;

(e) In the case of a nonresident alien, by authority of a foreign country, upon property or business (except income, war profits and excess profits taxes and taxes assessed against local benefits.)

Deductions for taxes are not limited to taxes paid in connection with the taxpayer's business, but are properly deductible when paid under the circumstances above indicated. As in the case of other deductions, taxes accrued may be deducted if the books of the taxpayer are kept on an accrual basis.

State and Federal inheritance taxes are not deductible in computing the net income of an estate even though the will provides that such taxes shall be paid out of the residue.

Taxes Paid for Shareholders.—Banks or other corporations that pay taxes assessed against their stockholders on account of their ownership of the shares of stock issued by such banks or corporations cannot deduct the amount of taxes so paid. The shares of stock are the property of the stockholders and to the extent that the taxes assessed on the value of the shares of stock are property taxes the holders of the stock are primarily liable for their payment. Such payments are therefore regarded as in the nature of additional dividends, and must be included by the stockholder as income, but may be deducted by him as taxes paid. By including the amount paid as a dividend and taking a deduction for the same as a tax, the stockholder does not change the amount of his surtax, but reduces the normal tax by an amount equal to the normal tax on the amount of the dividends so added. If stock is sold and transferred between the date of assessment and payment of the tax, in the absence of a statute providing otherwise, the stockholder liable for the tax would have the benefit of the tax deduction in the return of income.

Taxes for Local Benefits.— Assessments paid for local benefits, such as street, sidewalk, and other like improvements, imposed because of and measured by some benefit inuring directly to the property, against which the assessment is levied, do not constitute allowable deductions from gross income. Taxes are considered assessed against local benefits when the property subject to the tax is limited to the property benefited, but such special assessments are not deductible even though an incidental benefit may inure to the public welfare.

If assessments are made for the purpose of maintenance or repair of local benefits, the taxpayer may deduct the assessments paid as an expense incurred in business if the payment of such assessments is necessary to the conduct of the business. Where the assessments are made for the purpose of constructing local benefits, the payments by the taxpayer are in the nature of capital expenditures and not deductible.

Federal Duties and Excise Taxes.—Import or tariff duties, business, license, privilege, excise, and stamp taxes are deductible as taxes imposed by the authority of the United States,

provided they are not added to and made part of the expense of the business, or to the cost of articles or merchandise with respect to which they are paid.

Taxes Paid in Behalf of Another.—Taxes paid in behalf of a taxpayer by a debtor on interest or other income paid by such debtor may be deducted as a business expense, except that tax paid to the Federal Government under a "tax-free" covenant contained in a corporate bond may not be deducted. Where, however, tax is paid to a state in pursuance of such a covenant it is deductible as interest paid on indebtedness.

Losses

The 1918 law provides that in computing net income, losses shall be deductible as follows:

> Individuals–(a) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in trade or business;
>
> (b) Losses sustained during the taxable year and not compensated for by insurance or otherwise;
>
> (c) Losses sustained during the taxable year of property not connected with the trade or business, if arising from fires, storms, shipwreck or other casualty, or from theft, if not compensated for by insurance or otherwise;
>
> Corporations—Losses sustained during the taxable year and not compensated for by insurance or otherwise.

It is not necessary that losses be charged off within the taxable year, it being sufficient that they are charged off before they are allowed as deductions. Accordingly, at the time of examination of a corporation's return, a corporation is allowed to reopen its books and charge off losses actually sustained during the prior taxable year.

Individual Losses Not Connected with Trade or Business.—Under the 1918 law an individual is permitted to deduct in full losses incurred in transactions entered into for profit but not connected with his trade or business. The allowance of this deduction does not contemplate the deduction of losses in connection with transactions purely personal in character which are not entered into directly for profit. Thus, a loss on the sale of a house purchased and occupied by the taxpayer for his residence, or upon an automobile purchased exclusively for pleasure is not deductible.

Losses Through Fire, Flood or Other Casualty.—The amount of deductible loss in the case of destruction of property by fire, flood, or other casualty is the difference between the cost of the property or its fair market value as of March 1, 1913, and the salvage value after deducting from the cost or value as of March 1, 1913, the amount, if any, which should have been set aside and deducted in the current year and previous years from gross income on account of depreciation and which has not been paid out in making good the depreciation sustained. The loss should also be reduced by the amount of any insurance or other compensation received. The loss must be definitely ascertained, and if a claim is pending for settlement or insurance, no part of the loss which might have been compensated for through a settlement in favor of the taxpayer is deductible until the claim is adjusted.

Losses Must Be Actual.—Losses sustained from the sale or other dealings in property, of whatever kind, growing out of the ownership of or interest in such property, in order to be deductible, must not be speculative or fluctuating valuations of continuing investment, but must represent absolute losses actually sustained and ascertained during the taxable year for which the deduction is sought. Such a loss must be determined as a result of an actual completed and closed transaction. Book values merely reflecting a shrinkage in the value of securities are not a proper basis for determining gain or loss, even though such securities are written off at the direction of the Comptroller of the Currency, or a state bank official.

Mere book entries do not constitute a loss for the purpose of this deduction. Losses of the character contemplated by the law are only ascertainable in the case of securities, when such securities mature or are disposed of or cancelled, an exception being made, of course, in the case of dealers in securities and in merchandise.

If stock of a corporation becomes worthless, its cost or the fair market value as of March 1, 1913, if acquired prior to that date, may be deducted by the owner for the year in which the stock was ascertained to be worthless and charged off, but a satisfactory showing of its worthlessness must be made, as in the case of bad debts.

Termination of Usefulness of Property.—If, through some change in business conditions, the usefulness in the business of any of the capital assets is suddenly terminated, so that the taxpayer discontinues the business or discards such assets permanently from use in the business, he may claim as a loss for the year in which

he takes such action the difference between the cost or the fair market value as of March 1, 1913, of any asset so discarded (less any depreciation allowance) and its salvage value remaining. This exception to the rule requiring a sale or other disposition of property in order to establish a loss requires proof of some unforeseen cause by reason of which the property must be prematurely discarded, as, for example, where machinery or other property must be replaced by a new invention, or where an increase in the cost of or other change in the manufacture of any product makes it necessary to abandon such manufacture, to which special machinery is exclusively devoted, or where new legislation directly or indirectly makes the continued profitable use of the property impossible. The exception does not extend to a case where the useful life of property terminates solely as a result of those gradual processes for which depreciation allowances are authorized, nor does it apply to inventories or to other than capital assets. The exception applies to buildings only when they are permanently abandoned or permanently devoted to a radically different use, and to machinery only when its use as such is permanently abandoned. Any loss to be deductible under this exception must be charged off on the books and fully explained in returns of income. The loss here referred to should not be confused with the deduction for amortization.*

Old Buildings Razed for Construction of New.—When a taxpayer buys real estate upon which is located a building which he razes with a view to erecting another building in its place, no deductible loss is sustained by reason of the demolition of the old building, nor will there be any deductible expense on account of the cost of removal, the value of the real estate, exclusive of old improvements, being presumably equal to the purchase price of the land and buildings, plus the cost of removing the useless building.

Voluntary Removal of Buildings.—Loss due to voluntary removal or demolition of old buildings, and the scrapping of old machinery and equipment incident to renewals and replacements, is deductible from gross income in a sum representing the difference between the cost of the demolished or scrapped property and the amount of reasonable allowance for depreciation which it had undergone prior to its demolition or scrapping. The deductible loss is only so much of the original cost of the property, less salvage, as

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*See page 87.

would have remained unextinguished had a reasonable allowance been charged off for depreciation during each year prior to destruction.

Bad Debts

Bad debts ascertained to be worthless and charged off within the taxable year may be deducted, whether or not such debts were incurred in the business or trade. An account merely written down, however, or recognized as worthless prior to the beginning of the taxable year is not deductible. Only those losses on account of bad debts which have been definitely ascertained to have occurred during the taxable year are deductible, and the taxpayer must be able to show not only that the debt was worthless, but that it was definitely determined to be worthless at the time charged off, and was not recognized as worthless prior to the beginning of the year for which return was made.

Debts Arising from Capital.—All debts representing amounts that became due and payable prior to March 1, 1913, and not ascertained to be worthless prior to that date, whether representing income or a return of capital, are allowable deductions for the year in which they are ascertained to be worthless and charged off. The value used in computing such losses shall be the fair market value of the debt as of that date. Debts arising on and after March 1, 1913, on account of items of income are not proper deductions, unless such amounts have been included as income in the year in which earned or accrued.

Determination of Worthlessness.—Where all of the surrounding and attending circumstances indicate that a debt is worthless and not collectible, and that legal action to enforce payment would not result in the satisfaction of execution on a judgment, a showing of these facts would be sufficient evidence of the worthlessness of the debt for the purpose of the deduction. For example, the report of a mercantile agency of the financial condition of the debtor should be sufficient evidence to establish the status of the debt.

Bankruptcy may or may not be an indication of the worthlessness of a debt, and the actual determination of worthlessness in such a case is sometimes possible before or at other times only after a settlement in bankruptcy shall have been had. In cases in which bankruptcy proceedings are instituted, and the report of the receiver shows a definite loss, the taxpayer should be permitted to

take the loss so determined in the year in which the receiver's report is issued. Where the taxpayer has ascertained a debt to be worthless and charged it off in one year, the mere fact that bankruptcy proceedings instituted against the debtor are terminated in a later year, confirming the conclusion that the debt is worthless, will not authorize shifting the deduction to such later year. In any case, only the difference between the amount received in distribution of the assets of the bankrupt and the amount of the claim may be deducted as a bad debt. A debt voluntarily forgiven without adequate steps being taken to recover from the debtor, does not constitute a bad debt.

The difference between the amount received by a creditor of a decedent, in distribution of the assets of the decedent's estate and the amount of his claim may be considered a worthless debt. The purchaser of accounts receivable which cannot be collected and which are consequently charged off the books as bad debts, is entitled to deduct the value of such accounts, the amount of the deduction being based upon the price paid for them, if acquired subsequent to March 1, 1913, and not upon their face value. If a taxpayer computes his income upon the basis of valuing his notes or accounts receivable at their fair market value when received, the amount deductible for bad debts in any case is limited to such original valuation.

Mortgage Debt.—If a mortgagee buys in the mortgaged property and credits the indebtedness with the purchase price, the difference between the purchase price and the indebtedness is not an allowable deduction, but the determination of the loss is deferred until the property is disposed of. This rule does not apply where a purchase money mortgage is foreclosed by the vendor of the property. For deferred payment sales, see page 52.

Worthless Bonds.—Bonds ascertained to be worthless may be deducted as bad debts in the year in which ascertained to be worthless and charged off. If purchased prior to March 1, 1913 the amount deductible is the fair market value as of that date. If purchased on or after March 1, 1913, the cost of the bond is the amount deductible, but it may not exceed the amortized value, if purchased at a premium.

Depreciation and Obsolescence

Individuals and corporations may deduct a reasonable allowance for exhaustion, wear and tear of property used in the trade or busi-

ness, including a reasonable allowance for obsolescence. For convenience, this allowance is usually referred to as covering depreciation, excluding from the term any idea of mere reduction in the market value not resulting from exhaustion, wear and tear or obsolescence. Obsolescence was not mentioned in the law prior to 1918. The allowance for depreciation of property used in the trade or business is that amount which should be set aside for the taxable year in accordance with the consistent plan by which the aggregate of such amounts for the useful life of the property in the business will suffice, with the salvage value at the end of such useful life, to provide in place of such property its cost or its fair market value as of March 1, 1913, if acquired by the taxpayer prior to that date.

In the case of tangible property, it applies to that which is subject to wear and tear, to decay or decline from natural causes, to exhaustion, and to obsolescence due to the normal progress of the art or to becoming inadequate to the growing needs of the business. It does not apply to inventories or to stock in trade; nor to land, apart from improvements or physical developments added to it. The fact that deductions are made for ordinary and necessary repairs to the property does not prevent the deduction of a reasonable depreciation allowance.

The deduction for depreciation is limited to property used in the taxpayer's trade or business. Therefore, no depreciation may be taken on a taxpayer's residence, automobiles or other vehicles used for pleasure, or on furniture, clothing, or personal effects not used in the taxpayer's business.

Inasmuch as the depreciation allowance in prior years did not include obsolescence, the taxpayer, for the year 1918 and subsequent years, should revise the estimate of the useful life of any depreciable property so as to allow for such future obsolescence as may be expected from experience to result from the normal progress of the art or inadequacy of the property to the growing needs of the business. No modification of the method should be made on account of changes in market value of property from time to time, such as, on the one hand, loss in rental value of buildings due to deterioration of the neighborhood, or, on the other, appreciation due to increased demand. The conditions affecting such market values should be taken into consideration only so far as they affect the estimate of the useful life of the property.

Capital Recoverable Through Depreciation.—The capital sum to be replaced by depreciation allowances is the cost

of the property or the fair market value of such property on March 1, 1913, if acquired prior to that date. To this sum should be added, from time to time, the cost of improvements, additions and betterments, which cost has not been deducted as an expense in the taxpayer's return. Deductions should be made, from time to time, on account of any definite loss or damage sustained by the property through casualty, as distinguished from the gradual exhaustion of its utility, which is the basis of the depreciation allowance.

Method of Computing Depreciation Allowance.—The capital sum to be replaced should be charged off over the useful life of the property, either in equal annual installments or in accordance with any other recognized trade practice, such as an apportionment of the capital sum over units of production. No rate is fixed by which an allowable deduction on account of depreciation in value of any class of property subject to wear and tear is to be computed. The Department, in former years, without prescribing any definite rates, has estimated that the average useful life of a frame building is twenty-five years, a brick building thirty-five years, and a stone building, or steel and concrete building, from fifty to one hundred years, and that the average life of ordinary machinery is ten years, and of automobiles used for business or farm purposes and farm tractors, four to five years. The estimated life of the property, however, must be determined in each case by the character of the property and the use to which it is put.

Depreciation of Land and Securities.—Land is not reduced in value by reason of wear and tear and it therefore follows that no depreciation allowance may be taken in respect of the same. Likewise, no allowance may be taken to cover shrinkage in the value of stocks, bonds and like securities due to fluctuations in the market value, except in the case of dealers, who are permitted to inventory their securities.

Intangible Properties.—Intangible property, the use of which in the trade or business is definitely limited in duration, may be the subject of a depreciation allowance, for example, patents, copyrights, licenses and franchises. Intangibles, the use of which in the business or trade is not so limited, will not usually be a proper subject of such allowance. If, however, an intangible asset acquired through capital outlay is known from experience to be of value in the business for only a limited period, the life of which can be estimated from experience with reasonable certainty, such

intangible asset may be the subject of a depreciation allowance, provided the facts are fully shown in the return of the taxpayer.

In the case of a patent or copyright, the capital sum to be replaced in the cost of the patent (not already deducted as current expense), or its fair market value as of March 1, 1913, if acquired prior thereto. The allowance should be computed by an apportionment of the cost of the patent or copyright or its fair market value as of March 1, 1913, over the life of the patent or copyright, since its grant, or since its acquisition by the taxpayer, or since March 1, 1913, as the case may be.

A taxpayer who has incurred expenses for designs, drawings, patents, models, or work of an experimental nature calculated to result in improvement of the taxpayer's facilities or product, may at his option, deduct such expenses from gross income for the taxable year in which they are incurred, or treat such property as a capital asset to the extent of the amount so expended. In the latter case, if the period of usefulness of any such asset may be estimated from experience with reasonable accuracy, it may be the subject of depreciation allowances spread over such estimated period of usefulness.

If machinery or equipment is operated more than the usual number of working hours, a higher rate of depreciation may be taken than if operated under normal conditions.

Amortization

The taxpayer may make a reasonable deduction from gross income, not in excess of a sum sufficient to extinguish the cost of buildings, machinery, equipment, or other facilities constructed, erected, installed or acquired on or after April 6, 1917, for the production of articles contributing to the prosecution of the war, and of vessels constructed or acquired on or after such date for the transportation of articles or men contributing to the prosecution of the war. The provision is broad in its terms, and does not limit the deduction to property and facilities directly used for war purposes, but includes those contributing to the prosecution of the war. In the case of property, the construction or installation of which was commenced before April 6, 1917, and completed subsequent to that date, amortization will be allowed with respect only to the cost incurred on and after April 6, 1917.

Claims.—Claims for amortization must be unmistakably differentiated in the return from all other claims for depreciation,

obsolescence and loss. The allowance for amortization should cover the decline in value of the property subject thereto, and is inclusive of the depreciation which would ordinarily be allowable separately. Depreciation for any taxable period after December 31, 1917, should, therefore, not be claimed with respect to property as to which an allowance for amortization is claimed. The total amount to be extinguished by amortization in general is the excess of the unextinguished or unrecovered cost of the property over its maximum value, under stable postwar conditions. For the purpose of making returns for 1919, the total amount to be extinguished by amortization is the difference between the value of the property on the basis indicated in the following paragraphs, and the original cost of the property, less any amounts otherwise deducted for depreciation, losses, etc., prior to January 1, 1918; or in the case of property acquired or completed after December 31, 1917, it is the difference between the value of the property on the basis indicated below, and the cost of such property at the date of acquisition or completion:

(1) In the case of property useful only during the war period and permanently discarded at the date of the return, the basis is the salvage value as of the date when the property was discarded. In this case, for the purpose of making returns in 1919, the amount to be extinguished by amortization will be spread in proportion to the net income (computed without benefit of the amortization allowance) between January 1, 1918, and the date when the property was permanently discarded.

(2) In the case of property still in use, which will not be required for the future use of the business and which is certain to be permanently discarded before the last installment payment of the tax covered by the return, the basis is the salvage value as of the date when the property will be permanently discarded. In this case, for the purpose of making returns in 1919, the amount to be extinguished by amortization shall be spread in proportion to the net income (computed without benefit of the amortization allowance) between January 1, 1918, and the date upon which the property will be permanently discarded.

(3) In the case of other property, the basis for amortization calculation shall be the estimated value of the property to the taxpayer in terms of its actual use or employment in his going business, such value in no case to be less than the sale or salvage value of the property. In no case, however, shall the pre-

liminary estimate (for purposes of returns to be made in 1919) of the amount of such amortization exceed 25 per centum of the cost of the property. In the final determination, the amount of the amortization allowance will be ascertained upon the basis of stable postwar conditions when these conditions become apparent. For the purpose of making returns in 1919, the amount to be extinguished by amortization shall be spread in proportion to the net income (computed without the benefit of the amortization allowance) between January 1, 1918, and April, 1919.

A special record of all property falling in classes (1) and (2) must be preserved by the taxpayer, and the Commissioner must be promptly advised (a) if such property is restored to use; (b) the selling price if sold; and (c), if still on hand and not in use at the close of the three year period, the reasons why such property has not been disposed of.

All taxpayers claiming an allowance for amortization will be required to estimate the amount of their net income for the period between January 1, 1918, and the dates specified above, and also to estimate what part of such net income is properly allocable to the calendar year 1918 and what part to the calendar year 1919. These estimates will be the basis for apportioning the amounts to be extinguished by amortization between the calendar years 1918 and 1919. Taxpayers reporting on the fiscal year basis (a) in all computations based upon 1918 rates must use the amount of such allowance apportioned to the calendar year 1918; (b) in any computation based upon 1919 rates for a year beginning in 1918 and ending in 1919, must use the amount of such allowance apportioned to the calendar year 1919; and (c) in any computation for a fiscal year beginning in 1919 must use as many twelfths of the allowance apportioned to the calendar year 1919 as there are months of such fiscal year falling in the calendar year 1919.

Evidence to Be Furnished by Taxpayer.—The regulations provide that the taxpayer must establish to the satisfaction of the Commissioner that the entire deduction claimed and the proportion claimed for any particular year are reasonable. The taxpayer must submit a statement setting forth the following information:

(a) a description of the property in reasonable detail;

(b) the date or dates on which the property was acquired, and from whom, or, if constructed, erected, or installed by the taxpayer, the dates on which such construction, erection or installation was begun and completed;

(c) evidence establishing the intention of the taxpayer on and after April 6, 1917, or on and after the date of the acquisition or the date of beginning construction, erection, or installation to devote such property or vessels to the production of articles (or, in the case of vessels, the transportation of articles or men) contributing to the prosecution of the present war;
(d) the cost of construction, erection, installation or acquisition;
(e) the value of the property after termination of the amortization period;
(f) a segregation of the property permanently discarded, or of the property which will be permanently discarded, before the last installment payment covered by the return;
(g) all deductions from gross income otherwise taken or claimed with respect to such property;
(h) the computation by which the total amount to be extinguished by amortization was determined; and,
(i) the computation by which the proportion of the amortization charge claimed as a deduction in the taxable year for which the return is being made was determined.

Redetermination of Deduction.—A redetermination of the deduction allowed on account of amortization may, or at the request of the taxpayer shall be made by the Commissioner at any time within three years after the termination of the present war, and if as a result of an appraisal or from other evidence it is found that the deduction originally allowed was incorrect, the amount of tax due for each taxable year during the amortization period will be adjusted by additional assessment or by refund.

Depletion

The 1918 law allows a deduction of a reasonable allowance for depletion of natural deposits and for depreciation of improvements in the case of mines, oil and gas wells, other natural deposits, and timber, the deduction being taken according to the peculiar conditions of each case based upon cost, including the cost of development not otherwise deducted. In the case of such property acquired prior to March 1, 1913, the fair market value as of that date must be taken in lieu of the cost up to that date. In the case of the discovery of mines, oil and gas wells on or after March 1, 1913, not acquired as a result of the purchase of a proven tract or lease, if the fair market value is materially disproportionate to the cost, the depletion allowance will be based on the fair market value on the date of discovery or within thirty days thereafter. The allowance in the above cases is to be made under such regulations as are prescribed by the Commissioner; and in the case of leases the deduction must be apportioned between the lessor and the lessee.

Depletion Allowance in the Case of Owner.—In the case of an operating owner in fee or a lessor, the capital remaining in any year recoverable through depletion allowances is the sum of

(a) the cost of the property, or its fair market value as of March 1, 1913, or its fair market value within 30 days after discovery, as the case may be, plus
(b) the cost of subsequent improvements and development not charged to current operating expenses, but minus
(c) deductions for depletion which have or should have been taken to date, and
(d) the portion of the capital account, if any, as to which depreciation has been and is being deducted instead of depletion.

The value of the surface of the land should be taken into consideration, but a lessor may not include in his capital recoverable through such an allowance any part of development costs not borne by the lessor, nor any part of the discovery value.

Depletion Allowance in the Case of Lessee.—In the case of a lessee the capital remaining in any year recoverable through depletion allowances is the sum of

(a) the cost of the leasehold, or its fair market value as of March 1, 1913, or its fair market value within 30 days after discovery, as the case may be, plus
(b) the cost of subsequent improvements and development not charged to current operating expenses, but minus
(c) deductions of depletion which have or should have been taken taken to date, and
(d) the portion of the capital account, if any, as to which depreciation has been and is being deducted instead of depletion.

Any annual or periodical rents or royalties supplementing the bonus or other amount paid for the lease may be charged to current operating expenses or, until the property reaches the operating stage, to capital account, and in the latter event will form part of the capital returnable through deductions for depletion.

Depletion AllowanceApportioned Between Lessor and Lessee.—As the value of property comprehends the interests of both lessor and lessee, no computation, for the purpose of depletion allowances, of the value of these interests separately as of any date which combined exceeds the value of the property in fee simple will be permitted. This principle is applicable to holders of fractional interests. If the aggregate deduction claimed is deemed excessive, the Commissioner may request the owner or lessee to show that the valuation claimed does not exceed the fair

market value of the property at a specified date determined in accordance with prescribed regulations. The lessor and the lessee, with the approval of the Commissioner, must equitably apportion the allowance in the light of the peculiar conditions in each individual case and on the basis of their respective interests therein. Every taxpayer claiming an allowance for depletion in respect of property in which he owns a fractional interest only, or a leasehold, or property subject to a lease, must attach to his return a statement showing the name and address and the precise nature of the holdings of each person interested in the property. The regulations covering the determination of the allowance are set forth in detail in Regulations 45, Arts. 201 to 233.

Contributions

Contributions or gifts made within the taxable year by an individual are deductible to an aggregate amount not in excess of 15 per centum of the taxpayer's net income, computed without the benefit of this deduction, if made to corporations and associations organized and operated exclusively for religious, charitable, scientific or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual, or if made to the special fund for vocational rehabilitation authorized by Section 7 of the Vocational Rehabilitation Act. There must be stated on the return the name and address of the organization to which a gift was made and the amount and approximate date of each such gift. Where the gift is other than money, as, for example, a house, the basis of calculation of the amount of the gift will be the fair market value of the property at the time given. A gift of real estate made to a city to be maintained perpetually as a public park, is not an allowable deduction under the heading of contributions.

Loss on Inventories and Rebates

At the time of filing returns for the taxable year 1918, a taxpayer was allowed to file a claim in abatement (Form 47) based on the fact that he had sustained a substantial loss, whether or not actually realized by sale or other disposition resulting from any material reduction (not due to temporary fluctuation) of the value of the inventory for such year. In such case, payment of the amount of the tax covered by such claim was not required

until the claim was decided, but the taxpayer was compelled to accompany his claim with a bond in double the amount of the tax covered by the claim, with sureties satisfactory to the Commissioner, conditioned for the payment of any part of such tax found to be due, with interest. Similar relief was given in the case of losses resulting from the actual payment, after the close of the taxable year 1918, of rebates in pursuance of contracts entered into during such year upon sales made therein.

The taxpayer, however, in lieu of such claim for abatement, may file a claim for refund on Form 46 not later than thirty days after the close of the taxable year 1919, adjusting the entire claim for losses at the close of such year.

Determination of Losses.—Inventory losses were allowable either (a) where goods included in an inventory at the end of the taxable year 1918 were sold at a loss during the succeeding taxable year, or (b) where such goods remain unsold throughout the taxable year 1919 and at its close have a then market value (not resulting from a temporary fluctuation) materially below the value at which they were inventoried at the end of the taxable year 1918. A deduction is not permitted for loss of anticipated profits, for a loss not substantial in amount, or for physical damage or obsolescence occurring in the taxable year 1919. In determining whether goods included in the inventory at the end of the taxable year 1918 have been sold during the succeeding taxable year, and whether loss has resulted therefrom, sales of goods made in the taxable year 1919 will be deemed to have been made from the inventoried stock of 1918 until such inventoried stock is exhausted.

Should any goods unsold, upon which a claim in abatement has been filed at the time of filing return, be disposed of by sale at some future period within the taxable year 1919, the taxpayer should keep a record of the sales effected, deducting therefrom the proportionate cost of operating and selling expenses. The gain or loss would then be ascertained by computing the difference between the adjusted sales values and the inventory value established at the time of filing the claim in abatement. If, at the close of the taxable year 1919 there remains any commodity unsold, the taxpayer should adjust the inventory value to the market price, ignoring mere temporary fluctuations in price or value, at the close of the taxable year and compute the amount of gain or loss. Such gain or loss is to be combined with the gain or loss on sales between the time of filing the return and the close of the taxable year 1919.

If it appears that the taxpayer has sustained a loss in addition to that shown in the claim in abatement, a claim for refund should be made on Form 46 for the amount of tax overpaid. Should it be shown that the amount deducted in the claim in abatement at the time of filing the return for the taxable year 1918 is in excess of the tax based upon actual losses sustained throughout the taxable year 1919, the taxpayer must remit to the collector the additional amount of tax involved with interest at the rate of one per centum per month from the time of filing the return until the date of filing the final adjustment of taxes for the taxable year 1918 on account of inventory losses.

What Claims Embrace.—Summarized statements covering all adjustments involved must be filed with the original claim and at the close of the taxable year 1919. The totals of these summaries should equal the total inventories maintained in detail by the taxpayer. Claims for losses in inventories of the taxable year 1918 embrace all items of the taxpayer's inventory, so that gains made in any sales of certain items or classes will be used to offset losses in others, and the net result as to the entire inventory determined. Therefore, if the final computation shows a net gain over all inventory items sold no claim for loss in any particular item or items can be sustained.

1919 Profits Adjusted.—If a claim for inventory loss is finally allowed, the net income for 1919, as established by the usual accounting methods, will be correspondingly higher as represented in the return for the taxable year 1919. The Department recommends that the accounting records of the taxpayer remain unchanged and that any adjustment of inventories be recorded in distinct accounts supported by adequate detailed schedules.

Loss from Rebates.—Where, after the close of the taxable year 1918, rebates have been bona fide paid, in pursuance of contracts entered into during such year, upon sales made therein, the net income for that year may be reduced by the deduction of the amount of such rebates actually paid. No deduction is permitted unless the profits from the sales have been included in the income for the taxable year 1918. A separate schedule should be submitted in such cases, showing the date of each rebate; the name and address of each party securing the benefit thereof; a description of the goods; the quantities; the sales value of each item; the amounts rebated, and the total included in the taxpayer's claim in abatement.

Rebates made during the taxable year 1919 on sales made during such year, where the goods to which the rebate applies were included in the inventory at the close of the taxable year 1918, will be considered as an adjustment of sales values in arriving at the loss on inventories for the taxable year 1918. Such loss cannot be included in the rebate claim, but the rebate may be considered in determining the sale price for the purpose of determining an inventory loss. Rebates made on goods acquired and sold subsequent to the end of the taxable year 1918 cannot be deducted as a 1918 loss.

Net Losses

Scope of Net Losses and Claim for Allowance Therefor.—Under the law the term "net losses" means either a business operating loss or a loss realized by a bona fide sale of property constructed or acquired on or after April 6, 1917, for the production of articles contributing to the prosecution of the war. Any net loss claimed must represent an actual net loss over and above all income, including tax-free income. Such losses will be allowed only in respect of a taxpayer having a taxable year beginning after October 31, 1918, and ending prior to January 1, 1920. Any such claim should be filed on Form 46 with the taxpayer's return of income for the taxable year 1919, and should contain a concise statement of the loss sustained, in accordance with the return, the nature of the loss, the amount of the taxpayer's net income for the taxable year 1918, the taxes paid by him with respect thereto, and all pertinent facts necessary to enable the Commissioner to determine the allowability of the claim. After one claim has been allowed, no further claim can be considered.

Allowance of Net Loss.—Any amount allowed by the Commissioner in respect to any such claim shall be deducted from the net income for the taxable year 1918 and the income and war profits and excess profits taxes, if any, for such year shall be recomputed accordingly, and any amount found to be due the taxpayer shall be credited or refunded. In any case in which such net loss exceeds the net income of such preceding taxable year such excess may be carried forward and claimed as a deduction in computing net income for the succeeding taxable year.

PART III. INCOME TAX—RETURNS, PAYMENTS, AND CLAIMS

RETURNS

Under the 1918 law, individuals, fiduciaries, partnerships, and corporations are required to make return on the basis of their annual accounting period, whether a calendar year or a fiscal year other than the calendar year. A taxpayer having an existing accounting period which is a fiscal year within the meaning of the statute not only needs no permission to make his return on the basis of such a taxable year, but is required to do so, regardless of the former basis of rendering returns. A taxpayer having no such fiscal year must make return on the basis of the calendar year.

Returns When Accounting Period Changed.—No return can be made for a period of more than 12 months. A separate return for a fractional part of a year is, therefore, required wherever there is a change (with the approval of the Commissioner) in the basis of computing net income from one taxable year to another taxable year, or wherever a taxpayer making his first return does so on a fiscal year basis. The requirements with respect to the filing of such a return and the payment of tax are the same as for a return for a full taxable year closing at the same time. When a return is made for a period less than a year, the tax shall be paid at the rate for the calendar year in which such period is included, and the credits for personal exemption and dependents shall be such proportion of the full credits as the number of months in such period bears to 12 months.

Individuals

Every individual whose net income is

(a) $1,000 or over, if single, or if married and not living with husband or wife, or
(b) $2,000 or over, if married and living with husband or wife,

must file a return for his taxable year, whether calendar or fiscal. Whether or not an individual is the head of a family, or has dependents, is immaterial in determining his liability to render a

return. If an individual is a married person living with husband or wife, no return need be made where their aggregate net income is less than $2,000; but a separate return must be made by each of them, regardless of the amount of the individual income of each, where their aggregate net income is $2,000 or over, unless they join in a single return. The husband shall include in his return the income derived from services rendered by his wife or from the sale of products of her labor if she does not file a separate return or join with him in a return setting forth her income separately.

The return may be made by an agent when by reason of illness, absence, or nonresidence, the person liable for the return is unable to make it, the agent assuming the responsibility for making the return and incurring liability to the specific penalties provided for erroneous, false, or fraudulent returns.

Form of Return.—The return shall be on Form 1040, Revised, when the net income exceeds $5,000, and on short Form 1040-A, Revised, when the net income does not exceed $5,000 and the part subject to normal tax, after applying the personal exemption and other credits, does not exceed $4,000.

Return of Income of Minor.—An individual under 21 years of age or under the statutory age of majority where he lives, whatever it may be, is required to render a return of income if he has a net income of his own of $1,000 or over for the taxable year, if single, or $2,000 or over, if married, and living with husband or wife. If a minor is dependent upon his parent who appropriates his earnings, such earnings are considered income of the parent. In the absence of proof to the contrary a parent will be assumed not to have emancipated his minor child and must include in his return any earnings of the minor.

Return of Income of Nonresident Alien.—A nonresident alien individual shall make or have made a full and accurate return on Form 1040, Revised, or 1040-A, Revised of income received from sources within the United States, regardless of the amount unless the tax has been fully paid at the source. Representatives of nonresident aliens in connection with any sources of income which such nonresident aliens may have within the United States shall make a return of such income, and pay the tax due, in all cases where the tax on the income in their receipt, control, or custody has not been withheld at the source. Where upon filing a return of income it appears that a nonresident alien is not liable

for tax, but nevertheless a tax has been withheld at the source, in order to obtain a refund, a statement should be attached to the return showing the amounts of tax withheld, with the names and addresses of all withholding agents.

Corporations

Every corporation, not exempt from tax under Section 231 of the law, must make a return of income, regardless of the amount of its net income. Such return shall be on Form 1120, for the calendar year, or Form 1120-A for a fiscal year, other than the calendar year, ending in 1919. A corporation which is in existence during any portion of a taxable year is required to make a return, but a corporation which has received a charter, but has never perfected its organization, and which has transacted no business and had no income from any source, may, upon presentation of the facts to the collector, be relieved from the necessity of making a return so long as it remains in an unorganized condition.

If the net income includes an amount in excess of $10,000 from Government contracts*, Form 1120-S must accompany the return.

Returns for Fractional Part of Year.—In the case of a corporation making its first return of income on the basis of a fiscal year and in the case of a corporation changing its accounting period, whether from calendar year to fiscal year, from fiscal year to calendar year, or from one fiscal year to another fiscal year, a separate return for a fractional part of a year is required.†

Returns of Foreign Corporations.—Every foreign corporation, not exempt under Section 231 of the law, (page 159), having income from sources within the United States, must make a return of income on Form 1120. If such a corporation has no office or place of business in the United States, but has a resident agent, he shall make the return. It is not necessary, however, that a foreign corporation shall be engaged in business or that it have any office, branch, or agency in the United States, in order that it be required to make a return.

Returns by Receivers.—Receivers, trustees in dissolution, trustees in bankruptcy, and assignees, operating the property or business of corporations, must make returns of income for such corporations on Form 1120, covering each year or part of a year during which they are in control. Notwithstanding that the powers and functions of a corporation are suspended and that

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* See page 116.
† See pages 32 and 112.

the property and business are for the time being in the custody of the receiver, trustee, or assignee, subject to the order of the court, such receiver, trustee, or assignee, stands in the place of the corporate officers and is required to perform all the duties and assume all the liabilities which would devolve upon the officers of the corporation were they in control.

Returns in Special Cases.—Where a corporation enters on its return an excess profits tax equal to the amount of the maximum tax, determined under Section 302 of the statute, (page 174), the items on Form 1120 which relate solely to invested capital for the taxable year need not be filled in. Likewise, in the case of a foreign corporation the same items may be disregarded, except that all schedules called for on pages 1 and 4 of the return with respect to its income within the United States should be filled in, and the income tax computed without claiming any specific exemption under Item 9. The Commissioner may at any time, however, call for any information which is not required to be entered on the return. In any case where a claim is made under Sections 327 and 328 of the statute, other than in the case of a foreign corporation, the corporation should fill out all items of the return so far as possible and submit a statement explaining why it is impracticable to fill out the entire return.

Consolidated Returns.—Affiliated corporations are required to file consolidated returns on Form 1120. The consolidated return shall be filed by the parent or principal reporting corporation with the collector of the district in which it has its principal office. Each of the other affiliated corporations shall file with the collector of its district Form 1122, along with the several schedules indicated thereon.

Foreign corporations and personal service corporations need not file consolidated returns.

When Corporations Are Affiliated.—Corporations will be deemed to be affiliated

(a) when one domestic corporation owns directly or controls through closely affiliated interests or by a nominee or nominees substantially all the stock of the other or others, or,

(b) when substantially all the stock of two or more domestic corporations is owned or controlled by the same interests.

The words "substantially all the stock" cannot be interpreted as meaning any particular percentage, but must be construed according to each particular case. The owning or controlling of 95 per

centum or more of the outstanding voting capital stock (not including the stock in the treasury) at the beginning of and during the taxable year will be deemed to constitute an affiliation within the meaning of the statute. Consolidated returns may, however, be required even though the stock ownership is less than 95 per centum. When the stock ownership is less than 95 per centum, but in excess of 50 per centum, a full disclosure of affiliations should be made, showing all pertinent facts. Such statement should preferably be made in advance of filing the return, with a request for instructions as to whether a consolidated return should be made. In any event such a statement should be filed as a part of the return. The words "the same interests" shall be deemed to mean the same individual or partnership or the same individuals or partnerships, but when the stock of two or more corporations is owned by two or more individuals or by two or more partnerships a consolidated return is not required, unless the percentage of stock held by each individual or each partnership is substantially the same in each of the affiliated corporations.

Change in Ownership During Taxable Year.—When one corporation owns substantially all the stock of another corporation at the beginning of any taxable year, but during the taxable year sells all or a majority of such stock to outside interests not affiliated with it, or when one corporation during any taxable year acquires substantially all the capital stock of another corporation with which it was not previously affiliated, a full disclosure of the circumstances of such changes in ownership shall be submitted to the Commissioner, who shall decide whether or not separate or consolidated returns shall be filed.

Corporation Deriving Chief Income from Government Contracts.—In the case of any affiliated corporation organized after August 1, 1914, and not a successor to a then existing business, 50 per centum or more of whose gross income consists of income derived from a Government contract or contracts made between April 6, 1917, and November 11, 1918, both dates inclusive, the net income and invested capital of such corporation shall be taken out of the consolidated net income and invested capital of the group of affiliated corporations and the corporation so segregated shall be separately assessed on the basis of its own invested capital and net income, the remainder of such affiliated group being assessed on the basis of the remaining consolidated invested capital and net income.

Consolidated Net Income of Affiliated Corporations.—Subject to the provisions covering the determination of taxable net income of separate corporations, and subject further to the elimination of intercompany transactions, the consolidated taxable net income shall be the combined net income of the several corporations consolidated, except that the net income of corporations organized after August 1, 1914, and not a successor to a then existing business, coming within the provisions of Section 240 (a) of the law shall be taken out.

Different Fiscal Years of Affiliated Corporations.—In the case of all consolidated returns, consolidated invested capital must be computed as of the beginning of the taxable year of the parent or principal reporting company, and the consolidated income must be computed on the basis of its taxable year. Whenever the fiscal year of one or more subsidiary or other affiliated corporations differs from the fiscal year of the parent or principal corporation, the Commissioner should be fully advised by the taxpayer in order that provision may be made for assessing the tax in respect of the period prior to the beginning of the fiscal year of the parent or principal company.

TIME AND PLACE FOR FILING RETURNS

Returns of income must be filed on or before March 15, of each year, or the fifteenth day of the third month following the close of a fiscal year other than the calendar year. The due dates for returns for different accounting periods and the dates of payment of installments of taxes are as follows:

End of Taxable year	Last Date for Return and Date of First Payment	Date of Second Payment	Date of Third Payment	Date of Fourth Payment
Dec. 31	Mar. 15	June 15	Sept. 15	Dec. 15
Jan. 31	Apr. 15	July 15	Oct. 15	Jan. 15
Feb. 28	May 15	Aug. 15	Nov. 15	Feb. 15
Mar. 31	June 15	Sept. 15	Dec. 15	Mar. 15
Apr. 30	July 15	Oct. 15	Jan. 15	Apr. 15
May 13	Aug. 15	Nov. 15	Feb. 15	May 15
June 30	Sept. 15	Dec. 15	Mar. 15	June 15
July 31	Oct. 15	Jan. 15	Apr. 15	July 15
Aug. 31	Nov. 15	Feb. 15	May 15	Aug. 15
Sept. 30	Dec. 15	Mar. 15	June 15	Sept. 15
Oct. 31	Jan. 15	Apr. 15	July 15	Oct. 15
Nov. 30	Feb. 15	May 15	Aug. 15	Nov. 15

A corporation going into liquidation, during any taxable year may, upon the completion of such liquidation, prepare a return covering its income for the fractional part of the year during which it was engaged in business and may file such return immediately.

Time for Filing Return upon Death or Termination of Trust.—As soon as possible after his appointment and qualification, an executor or administrator shall file a return of income for the decedent for the portion of the taxable year prior to death. Upon the completion of the administration and final accounting, an executor or administrator shall file a return of income of the estate for the portion of the taxable year in which the administration was closed, attaching to the return a certified copy of the order for his discharge. An ancillary administrator need make no separate return if the domiciliary administrator includes in his return the entire income of the estate.

Extension of Time by Collector.—In cases of sickness or absence, collectors are authorized to grant an extension of not exceeding 30 days, but the application for such extension must be made prior to the expiration of the period for which the extension is desired. The absence or sickness of one or more officers of a corporation will not be accepted as a reasonable cause for failure to file the return, unless there were no other principal officers available to make and verify the return.

Extension of Time by Commissioner.—If, before the end of an extension of 30 days granted by the collector, an accurate return cannot be made, an appeal for a further extension must be made to the Commissioner, but no such extension shall be granted beyond the original due date of the third installment of the tax. Either a complete or a tentative return must be submitted on or before the due date as extended, and the tax shown to be due paid at that time.

Extension of Time in the Case of Persons Abroad. An extension of time for filing returns of income for 1918 and subsequent years and for paying the tax is granted in the case of nonresident alien individuals and nonresident foreign corporations, or their proper representatives in the United States, and of American citizens residing or traveling abroad, including persons in military or naval service on duty outside the United States, for such period as may be necessary, not exceeding ninety days after proclamation by the President of the end of the war with Germany.

The whole tax shown to be due must be paid at the time of filing the return. In all such cases an affidavit must be attached to the return, stating the causes of the delay in filing it.

Extension of Time in the Case of Enemies.—A like extension to the one described in the foregoing paragraph is also granted for filing returns of income for 1918 and subsequent years and for paying the tax by or for nonresident enemies or allies of enemies, as defined by Section 2 of the Trading-with-the-Enemy Act of October 6, 1917, not holding licenses granted under the provisions of that act.

This extension, however, does not authorize any delay in filing returns of information, and is also subject to the condition that all persons who on October 6, 1917, had or since have had or may hereafter have control of any money or other property for any such enemy or ally of enemy, or who on October 6, 1917, were or since have been, or thereafter became indebted to any such enemy or ally of enemy, shall hold and deliver all such money and property subject to the Trading-with-the-Enemy Act and to the orders of the President and of the Alien Property Custodian, thereunder, and shall file returns of income in respect thereto for such period as may elapse or have elapsed prior to the actual delivery of such money and property to the Alien Property Custodian.

Last Due Date.—The last due date is the last day upon which a return is required to be filed or the last day of the period covered by an extension of time duly granted. When it falls on Sunday or a legal holiday, the last due date will be the day following. If placed in the mails, the return should be posted in ample time to reach the collector's office on or before the date on which the return is required to be filed, but no penalty will attach should the return not be actually received by such officer until subsequent to that date.

Place of Filing.—Returns of income must be filed with the collector for the district in which the legal residence or principal place of business of the person making the return is located. Persons having no domicile or place of business in the United States, and persons in the military or naval service of the United States, may file their returns with the collector at Baltimore, Md.

A corporation having an office or agency in the United States must make its returns to the collector of the district in which is

located its principal office or agency. Other corporations must make their returns to the collector at Baltimore.

Verification of Returns.—All income tax returns must be verified under oath or affirmation before an officer authorized to administer oaths. Returns executed abroad may be attested free of charge before United States consular officers. Where a foreign notary or other official having no seal shall act as attesting officer, his authority shall be certified to by some judicial official or other proper officer having knowledge of his appointment and official character.

Use of Prescribed Forms.—Copies of the prescribed return forms will so far as possible be furnished taxpayers by collectors. Failure on the part of any taxpayer to receive a blank form will not, however, excuse him from making a return. In lack of a prescribed form, a statement made by a taxpayer disclosing his gross income and the deductions therefrom may be accepted as a tentative return, and if filed within the prescribed time a return so made will relieve the taxpayer from liability to penalties, provided that without unnecessary delay such a tentative return is replaced by a return made on the proper form.

PAYMENT OF TAXES

Taxes, other than taxes paid at the source, are payable in four equal installments; the first at the time of filing the return and the others at intervals of three months thereafter. At the option of the taxpayer, the tax may be paid in a single payment, or if the time for filing the return has been extended, full payment may be made on or before the expiration of such extension. An unconditional extension of time for filing the return will postpone the date of payment of the first installment, but will not postpone the date of the payment of the other installments, unless so specified in each case.

If an installment of tax is not paid when due, all of the tax remaining becomes due and payable upon notice and demand. If upon recomputation of the tax it is found that the tax already paid exceeds the correct amount of the installment or of the whole tax, the excess shall be credited against subsequent installments or other similar taxes then due, or if no such installments or no such tax is due such excess shall be refunded to the taxpayer.

Interest on Tax.—Where the time for payment of any installment of tax is postponed at the taxpayer's request, interest at the rate of 6% per annum is added from the original due date. If an

understatement of tax in the return is due to negligence, but without intent to defraud, interest at the rate of 12% per annum is added to the amount of the deficiency of each installment from the time the installment was due. If any tax remains due and unpaid for ten days after notice and demand, or in case the first installment, as computed by the taxpayer, remains due and unpaid for ten days, interest at the rate of 12% per annum is added from the due date, except that the interest on any amount which is the subject of a bona fide claim for abatement shall be at the rate of 6% per annum, and except that no interest is added in the case of estates of insane, deceased, or insolvent persons. If any part of a claim for abatement on the ground of a loss in inventory is disallowed, interest from the original due date at the rate of 12% per annum will be added to the tax not abated. Interest is also added when the demand for payment is made of the taxpayer personally, although he subsequently dies or becomes insane or insolvent, so that collection of the tax is made from his estate in the hands of his representative.

Notice and Demand of Payment.—Service of a notice and demand by the collector on Form 17 is complete upon mailing it, and the time within which the tax must be paid runs from the date of mailing the notice, and not of its receipt by the taxpayer. But payment for the tax must actually reach the collector within the ten-day period, and merely mailing the remittance before the expiration of ten days is not sufficient. In the case of taxpayers, however, who are absent from their homes or their places of business, in foreign countries, or in the military or other service of the United States, the collector will enter on the notice as the date on which the tax becomes due, a date as nearly as possible ten days after the time that the notice should be received by the taxpayer in the ordinary course of the mails. If it appears that a remittance for the tax was placed in the mail within the ten-day period or satisfactory evidence is produced to show that a notice was not delivered in due time, the penalty and interest will not be collected.

Payment of Tax by Uncertified Checks.—Collectors may accept uncertified checks in payment of income and excess profits taxes, provided such checks are collectible without any deduction for exchange or other charges. The day on which the collector receives the check will be considered the date of payment unless it is returned dishonored. If one check is remitted to cover two or more persons' taxes, the remittance must be accompanied by a letter of transmittal, stating

(a) the name of the drawer of the check;
(b) the amount of the check;
(c) the amount of any cash, money order, or other instrument included in the same remittance;
(d) the name of each person whose tax is to be paid by the remittance;
(e) the amount of the payment on account of each person; and
(f) the kind of tax paid.

Payment of Tax by Certificates of Indebtedness.—United States Treasury Certificates of Indebtedness may be accepted by the collector in payment of taxes at par, with an adjustment for accrued interest.

CREDIT FOR TAXES

Individuals

Under the Revenue Act of 1918, the income tax of an individual shall be credited with:

(a) In the case of a citizen of the United States, whether resident or nonresident, the amount of any income, war profits and excess profits taxes paid or accrued during the taxable year to any foreign country upon income derived from sources therein, or to any possession of the United States;
(b) In the case of a resident of the United States, such taxes paid or accrued during the taxable year to a possession of the United States;
(c) In the case of an alien resident of the United States, the amount of any such taxes paid or accrued during the taxable year to the country of which he is a citizen or subject, upon income derived from sources therein, only if such country permits a similar credit to citizens of the United States residing in such country.

Subject to the foregoing limitations, the members of a partnership, the stockholders of a personal service corporation, or the beneficiaries of an estate or trust may take credit for their proportionate share of any such taxes which may have been paid by the partnership, personal service corporation, estate, or trust.

Meaning of Terms.—The term "amount of taxes paid during the taxable year" means taxes proper (no credit being given for amounts representing interest or penalties) paid or accrued during the taxable year on behalf of the individual claiming credit. "Foreign country" includes within its meaning any foreign sovereign state or self-governing colony (for example, the Dominion of Canada), but does not include a foreign municipality (for example, Montreal) unless itself a sovereign state (for example, Hamburg).

"Any possession of the United States" includes, among others, Porto Rico, the Philippines, and the Virgin Islands.

Conditions of Allowance of Credit.—When credit is sought for income, war profits or excess profits taxes paid other than to the United States, the income tax return of the individual must be accompanied by Form 1116. When credit is sought for taxes already paid, the form must have attached to it the receipt for each such tax payment. When credit is sought for taxes accrued, the form must have attached to it the return on which each such accrued tax was based. The receipt or return so attached must be either the original, a duplicate original, a duly certified or authenticated copy, or a sworn copy. In case only a sworn copy of a receipt or return is attached, there must be kept readily available for comparison on request the original, a duplicate original or a duly certified or authenticated copy.

In the case of a credit sought for a tax accrued but not paid, in addition to Form 1116, the Commissionor may also require a bond in such penal sum as he may prescribe, conditioned for the payment by the taxpayer of any tax found due upon any redetermination of the tax made necessary by such credit proving incorrect, with such further conditions as the Commissioner may require. Form 1117 must be used when a bond is so required.

Redetermination of Tax When Credit Proves Incorrect.—In case credit has been given for taxes accrued, or a proportionate share thereof, and the amount that is actually paid on account of such taxes, or a proportionate share thereof, is not the same as the amount of such credit, or in case any tax payment credited is refunded in whole or in part, the taxpayer shall immediately notify the Commissioner. The Commissioner will thereupon redetermine the amount of the income tax of such taxpayer, and the amount of tax, if any, due upon such redetermination shall be paid by the taxpayer upon notice and demand by the collector.

Corporations

To secure a credit for taxes, a domestic corporation must pursue the same course as that prescribed for an individual, except that Form 1118 is to be used for claiming credit and Form 1119 for the bond, if a bond is required. The provisions with respect to the redetermination of tax when a return for such taxes has been rendered incorrect by later developments, apply also to a corporate taxpayer

Domestic Corporation Affiliated With Foreign Corporation.—A domestic corporation which owns a majority of the voting stock of a foreign corporation is entitled to credit its income, war profits and excess profits taxes with any income, war profits or excess profits taxes paid (but not including taxes accrued) by such foreign corporation during the taxable year to any foreign country or to any possession of the United States upon income derived from sources within the United States in an amount equal to the proportion which the amount of any dividends (not deductible under Section 234), but not in excess thereof, received by such domestic corporation from such foreign corporation during the taxable year, bears to the total taxable income of such foreign corporation upon or with respect to which such taxes were paid. A claim for credit in such a case is also to be made on Form 1118.

CLAIMS FOR ABATEMENT, REFUND AND CREDIT

The law provides different methods by which erroneous assessments may be corrected upon appeal to the Commissioner by the taxpayer. In any case where the taxpayer discovers that an error has been made in his return, an amended return should be filed. If an error is discovered or the taxpayer disputes a ruling of the Treasury Department after assessment is made and desires to correct the error prior to payment, a claim in abatement should be filed. If excessive tax has been paid under an erroneous or illegal assessment, recovery should be obtained by filing a claim for refund, or if taxes are due the Government by reason of another assessment, a claim for credit should be filed, requesting that the taxes illegally exacted should be applied to the assessment legally due. Failure to file a claim in abatement does not prevent recovery of tax after payment by claim for refund or credit. The method of correction of the error is optional; the taxpayer may proceed either before the tax is paid by claim for abatement, or if the tax has been paid, by claim for refund or credit. The fact that a claim in abatement has been filed and rejected does not preclude a subsequent claim for refund or credit.

Claims in Abatement.—Claims by the taxpayer for the abatement of taxes or penalties erroneously or illegally assessed, or abatable under remedial acts, should be made on Form 47, and must be sustained by affidavits of the parties against whom taxes were

assessed or of other parties cognizant of the facts, and such affidavits should contain complete and explicit statements of all material facts relating to the claim. When the tax has been assessed and paid, the presumption is that the assessment was properly and legally assessed, and the burden of proof in rebutting the presumption and establishing the claim rests upon the claimant. The filing of a claim for abatement does not necessarily operate as a suspension of the collection of the tax, and in any case where the collector deems it necessary he may collect the tax and leave the taxpayer to his remedy by claim for refund.

Claims for Credit.—As heretofore stated, any amount of tax paid in excess of that properly due shall be credited against any such taxes due from the taxpayer under any other return. In order to obtain the benefit of such credit the regulations provide that where the credit demanded is equal to or less than any outstanding assessment of tax, the taxpayer shall file with the collector for the district in which his original return was filed a claim on Form 47-A, which shall be sworn to, and shall contain the following facts:

(a) Business engaged in by claimant;
(b) Character of assessment;
(c) Amount of tax paid and for what taxable year;
(d) Portion of tax under (c) claimed as a credit;
(e) Unpaid assessment against which credit is asked and for what taxable year; and
(f) All facts regarding the overpayment.

If the amount claimed as a credit is greater than the outstanding assessment of tax, the taxpayer shall file, in addition to Form 47-A, a claim for refund of the overpayment in excess of the credit. Such claim for refund may be attached to the claim for credit or may be separately filed with the Commissioner.

Claims for Refund.—Claims by the taxpayer for refund of taxes and penalties erroneously or illegally collected should be made on Form 46, under oath. The burden of proof in the case of a claim for refund, as in the case of a claim for abatement, rests upon the claimant. All facts in support of the claim should be clearly set forth and it should be accompanied by the collector's receipt or cancelled check, showing payment of the tax. In the case of a claim on behalf of a decedent taxpayer, certified copies of the letters of administration or letters testamentary or other similar evidence showing the authority of the administrator or executor should be annexed to the claim. In any case where the claim is made by an agent of the taxpayer it must be accompanied by a power of attorney.

A taxpayer desiring to convert a claim for refund previously filed into a claim for credit may file with the collector a claim on Form 47-A, reference being made to such claim for refund. When received by the Commissioner, the claim for credit will be attached to the claim for refund and will be adjusted in the same manner as if the taxpayer had originally filed a claim for credit.

PENALTIES

A penalty of not more than $1,000 attaches for failure to punctually make a required return, whether of income, withholding, or information, or to pay or collect a required tax. If the failure is wilful, however, or an attempt is made to defeat or evade the tax, the offender is liable to imprisonment and to a fine of not more than $10,000 and costs. In addition to these specific penalties, ad valorem penalties are imposed in various cases. An ad valorem penalty is assessed and collected as a part of the tax, while a specific penalty is recoverable only by suit. See Section 250 of the statute.

Failure to File Return.—In case of failure to make a return on time, a penalty of 25% of the amount of the tax is added, unless the return is later filed and the failure to file is satisfactorily shown to be due to a reasonable cause. Two classes of delinquents are liable to the penalty: (a) those who do not file returns and for whom returns are made by a collector or the Commissioner; and (b) those who file tardy returns and are unable to show reasonable cause for the delay. Taxpayers wishing to avoid the penalty must make an affirmative showing of the facts alleged as a reasonable cause for failure to make a return on time in the form of an affidavit under oath, which should be attached to the return, and if the Commissioner determines that the delinquency was due to a reasonable cause the 25% penalty will not be assessed.

Understated Return.—(a) If an understatement of tax in a return of income is due to negligence, but without intent to defraud, a penalty of 5% of the amount of the deficiency is added; but (b) if the understatement is false with intent to evade the tax, a penalty of 50% of the deficiency is added. If a false or fraudulent return is wilfully made, other than as specified in (b) above, a penalty of 50% of the amount of the tax is added. (See Section 3176 Revised Statutes.)

PART IV. EXCESS PROFITS TAX

Imposition of Tax

The Act of 1918 imposes a straight excess profits tax on corporations, for the year 1919. The war profits tax, effective for the calendar year 1918, extends in 1919 only to corporations receiving net income of $10,000 or more from Government contracts, and to corporations with a fiscal year beginning in 1918 and ending in 1919. Inasmuch as this latter class of corporations is comparatively small and this booklet deals principally with returns for the taxable year 1919, the discussion of the excess profits tax, except in a few instances, omits reference to the war profits tax.

Under the excess profits tax for 1919, individuals and partnerships are exempt from tax. All corporations except the following are subject to tax:

(a) Certain classes of corporations not organized for profit, which are exempt from income tax under Section 231 of the law,

(b) Net income of corporations derived from the mining of gold,

(c) Personal service corporations,

(d) Corporations whose net income for the full taxable year is less than $3,000. A corporation rendering a return for a fractional part of a year, whose net income is less than the same proportion of $3,000 as the number of months in the period is of twelve months, is exempt from excess profits tax. For the purpose of this computation, a fractional part of a month will be counted as the number of days in such part of a month divided by 30.

Computation of Tax.—The excess profits tax, like the income tax, is a tax on net income. The rates of tax for 1919 and thereafter, except in the case of a corporation which derives in any taxable year after 1918, a net income of more than $10,000 from any Government contracts made after April 5, 1917, and before November 12, 1918, are as follows:

First Bracket: 20 per centum of the net income in excess of the excess profits credit and not in excess of 20 per centum of the nvested capital;

Second Bracket: 40 per centum of the net income in excess of 20 per centum of the invested capital.

As applied to a specific case, the excess profits tax and the income tax for 1919 of a corporation is computed as follows:

Net Income for Taxable Year........	$250,000
Invested Capital for Taxable Year...	700,000
Excess Profits Credit (See page 119.).	59,000

COMPUTATION OF TAX

FIRST BRACKET: 20% of ($140,000 less $59,000)...	$81,000	$16,200
SECOND BRACKET: 40% of..	110,000	44,000
Total Excess Profits Tax..........		60,200
Income Tax at 10% of ($250,000 less $62,200)...	187,800	18,780
Total..........................		$78,980

In order to compute the excess profits tax for 1919, it is not necessary to give any data for the prewar period, either as to net income or invested capital. For any taxable year ending in 1919 other than December 31, 1919, it is necessary to compute the tax both under the rates effective for 1918 and the rates effective for 1919 in order to determine the tax due for the fiscal year (See Form 1120-A).

Return for Less Than a Year.—The following illustrates the computation of excess profits tax where a return is made for a period of six months.

Invested Capital..................	$120,000
Net Income.......................	50,000

The excess profits credit is computed by adding the specific exemption of $3,000 to 8 per centum of the full invested capital of $120,000, or $9,600, a total of $12,600, and taking 6/12 of this result, or $6,300, as the excess profits credit.

FIRST BRACKET.—The amount of the net income ($50,000) in excess of the excess profits credit ($6,300) and not in excess of 6/12 of 20 per centum of the invested capital (i. e., 6/12 of 20 per centum of $120,000), or $12,000, is $5,700. The tax computed under this bracket is 20 per centum of this amount (i. e., 20 per centum of $5,700), or $1,140.

SECOND BRACKET.—The amount of the net income ($50,000) in excess of 6/12 of 20 per centum of the invested capital (i.e., 6/12 of 20 per centum of $120,000), or $12,000, is $38,000. The tax computed under this bracket is 40 per centum of this amount (i. e., 40 per centum of $38,000), or $15,200.

The total excess profits tax will be the sum of the taxes computed under the two brackets (i. e., $1,140 plus $15,200), or $16,340.

Income in Part from Business with Invested Capital.—By the terms of Section 303 of the statute, a special method of assessment is made applicable to a corporation which derives income from business with invested capital and from a business without invested capital, the net income of which latter business constitutes not less than 30 per centum of the entire net income of such corporation and which, if transacted alone, would class it as a personal service corporation. In such cases the tax upon the net income from each class of business is computed separately. The tax upon the income from the business with invested capital is computed upon the basis of

(a) Such part of the entire invested capital for the taxable year as has been employed in the production of the net income upon which the tax is being computed; and

(b) The same proportion of the specific exemption and excess profits credit which the part of the net income upon which the tax is being computed is of the entire net income.

The tax upon the personal service part of the net income is the same percentage thereof as the tax computed on the net income from business with invested capital is of the net income of such business with invested capital. This tax, however, shall, in no case, be less than 20 per centum of the personal service part of the entire net income, unless the tax upon the entire net income if computed in the ordinary way would be less than 20 per centum of such entire net income. In that event, and in any case in which the amount of the total tax as computed under this provision is the same as or greater than the tax as computed in the ordinary way, the tax shall be computed under Section 301 of the statute.

The following is an illustration of the computation of tax where income is partly derived from business with invested capital and partly from business without invested capital:

A corporation engaged in contracting work in which the employment of capital is necessary, also renders consulting engineering service, a personal service business which if constituting its sole business would bring it within the class of personal service corporations.

Invested Capital used in Contracting	$81,000	
Invested Capital used in Engineering	19,000	
Total Invested Capital		$100,000
Net Income Derived from Contracting	$30,000	
Net Income Derived from Engineering	60,000	
Total Net Income		90,000

Tax on Net Income from Contracting:			
Excess Profits Credit $1,000 (same proportion of $3,000 as $30,000 is of $90,000) plus 8% of $81,000, or $6,480, a Total Credit of $7,480.			
First Bracket—20% of $8,720 ($16,200 less $7,480)	$1,744		
Second Bracket—40% of $13,800	5,520		
Tax on Net Income from Contracting		$7,264	
Tax on Net Income from Engineering:			
Tax on Net Income from Contracting is 24.21% of $30,000 (Net Income from Contracting); therefore, Tax on Net Income from Engineering is 24.21% of $60,000 or		14,526	
Total Tax on Net Income from Entire Business			$21,790

Apportionment of Invested Capital.—For the purpose of determining whether or not a corporation partly partaking of the nature of a personal service corporation is within the scope of Section 303 of the statute and also for the purpose of establishing the basis for the computation of the tax, the corporation shall apportion or allocate its invested capital between each trade or business or branch thereof as nearly as may be in accordance with the actual facts, and shall submit with its return an explanatory statement setting forth the manner in which the apportionment of the invested capital employed in the production of each part of its net income has been determined. There must be assigned to any personal service trade or business or branch thereof an amount of invested capital at least as great as that which would ordinarily be employed by a personal service corporation of similar size and standing for the payment of salaries and office expenses, maintenance of library and equipment, credit advances to clients, etc.

Apportionment of Net Income.—Whenever it is necessary to determine the portion of the net income derived from or attributable to a particular source, the corporation shall allocate to the gross income derived from each source the expenses, losses, and other deductions properly appertaining thereto, and shall apply any general expenses, losses, and deductions (which cannot otherwise be properly apportioned) ratably to the gross income from all sources. The gross income derived from a particular source, less

the deductions properly appertaining thereto and less its proportion of any general deductions, is the net income derived from such source. A corporation is required in such cases to submit with its return a statement fully explaining the manner in which such expenses, losses and deductions were allocated or distributed.

Income from Gold Mining.—If a corporation is engaged in the mining of gold, the portion of its net income derived from that source is exempt from tax. The tax on the remaining portion of its net income is the proportion of the tax that would have been payable had the entire net income been derived from other sources than the mining of gold, which such remaining portion of the net income bears to the entire net income. To determine the net income derived from each source, the method explained on page 114 should be followed.

The following is an illustration of the computation of the tax of a corporation, part of whose income is derived from the mining of gold.

In the case of the corporation used as an illustration on page 112, let it be assumed that it is engaged in the mining both of gold and of other rare metals; that the Commissioner finds that $100,000 of the net income was attributable to the mining of gold and exempt from tax. The remaining portion of the net income is $150,000 and the tax thereon is the same proportion of the tax computed on the entire net income without the benefit of the exemption (i. e., a tax of $60,200) which the remaining portion of the net income ($150,000) bears to the entire net income ($250,000). The tax will therefore be three-fifths of the tax of $60,200, computed without the benefit of the exemption, or $36,120.

Sale of Mineral Deposits.—In order to encourage prospecting and exploration or discovery work, under Section 337 of the Act of 1918, Congress placed a limitation on the tax on the sale of mines, oil or gas wells. The law provides that in the case of a bona fide sale of mines, oil or gas wells, or any interest therein, where the taxpayer, by prospecting and locating claims, or by exploring and discovering undeveloped claims, has demonstrated the principal value of such mines or wells, which, prior to his efforts had a merely nominal value, the portion of the excess profits tax attributable to such a sale shall not exceed 20 per centum of the selling price. To determine the application of this provision to a particular case, the corporation should compute the excess profits tax in the ordinary way upon its net income, including its net income from any such sale. The proportion of the total tax indicated by the ratio which the tax-

payer's net income from the sale of the property, bears to its total net income, is the portion of the tax attributable to such sale, and if it exceeds 20 per centum of the selling price of the property such portion of the tax shall be reduced to that amount. To determine the net income derived from each source, the method explained on page 114 should be followed.

In the case of the corporation used as an illustration on page 112, let it be assumed that its net income for 1919 included $100,000 derived from a bona fide sale of an oil well at $120,000, the principal value of which had been demonstrated by exploration and discovery work done by the corporation. The portion of the net income attributable to the sale, namely $100,000, is 40 per centum of the entire net income of $250,000 and the portion of the tax for that year attributable to the sale will be 40 per centum of the entire tax of $60,200, or $24,080. But, this portion of the tax cannot exceed 20 per centum of the selling price, $120,000, and is accordingly reduced to $24,000. The total tax will be $36,120 (the portion of the tax not affected) plus $24,000, or $60,120 (instead of $60,200).

Computation of Tax on Income from Government Contracts after 1918.—If a corporation derives in any taxable year after 1918 net income of more than $10,000 from any Government contracts made after April 5, 1917, and before November 12, 1918, the tax shall be such a proportion of a tax computed at the rates for 1918 as the portion of the net income attributable to the Government contracts bears to the entire net income, plus such a proportion of a tax computed at the rates for 1919 as the amount of the remaining net income bears to the entire net income. In computing such taxes, however, the excess profits credit and the war profits credit applicable to the taxable year shall be used. The method of determining the net income attributable to such contracts is the same as that explained on page 114.

Limitation on Tax.—Protection is afforded small corporations from excessive payments by placing a limitation on the amount of tax which may be collected. For the year 1919 and thereafter, the tax shall not exceed the sum of 20 per centum of the net income in excess of $3,000 and not in excess of $20,000, plus 40 per centum of the net income in excess of $20,000. This limitation is of especial importance to corporations having a small income and small invested capital. For example, a corporation with a net income for the taxable year 1919 of $20,000, and invested

capital of $5,000, would be subject to a tax of $6,640 if computed in the ordinary manner, the method of computation being as follows:

Net Income			$20,000
Credit			
8% of Invested Capital	$400		
Specific Exemption	3,000		
Total		3,400	
Income Taxable at 20%			None
Income Taxable at 40%			16,600
Excess Profits Tax			6,640

The limitation, however, confines this tax to 20 per centum of $17,000, or $3,400.

When a return is rendered for a fractional part of a year, the limitation is computed by taking that proportion of $3,000 and of $20,000, respectively, which the period covered by the return bears to a full year. The rates of tax, however, are not affected and should be applied as in the ordinary case.

It is specifically provided that nothing contained in the law providing for this limitation shall be construed so as to increase the tax imposed in the regular manner.

Computation of Tax in Special Cases.—Section 328 of the law provides that in certain cases, the tax will be the amount which bears the same ratio to the net income of the taxpayer (in excess of the specific exemption of $3,000) for the taxable year, as the average tax of representative corporations engaged in a like or similar trade or business bears to their average net income (in excess of the specific exemption of $3,000) for such year. In the case of foreign corporations, the tax shall be computed without deducting a specific exemption of $3,000, either for the taxpayer or the representative corporations.

Cases Falling Under Section 328.—The law provides that assessment under Section 328 shall be made in the following cases:

(a) Where the Commissioner is unable to determine the invested capital of the corporation;

(b) In the case of a foreign corporation;

(c) Where a mixed aggregate of tangible property and intangible property has been paid in for stock or for stock and bonds and the Commissioner is unable satisfactorily to determine the respective values of the several classes of property at the time of payment, or to distinguish the classes of property paid in for stock and for bonds;

(d) Where, upon application by the corporation, the Commissioner finds that the tax if determined in the ordinary way would, on account of abnormal conditions affecting the capital or income of the corporation, work upon the corporation an exceptional hardship

evidenced by gross disproportion between the tax so computed and the tax computed by reference to the representative corporations specified in Section 328.

This special method of computation does not apply to any case under subdivision (d) above in which (1) the tax computed in the ordinary way is high merely because the corporation earned within the taxable year a high rate of profits upon a normal invested capital; nor (2) in which 50 per centum or more of the gross income of the corporation for the taxable year consists of income derived on a cost-plus basis from a Government contract made between April 6, 1917, and November 11, 1918, both dates inclusive.

The tax will not ordinarily be computed under Section 328 merely because the form or manner of organization of the corporation, or the limitations imposed by Section 326, result in a greater tax than would otherwise be payable.

A corporation which comes within the provisions of subdivision (d) of Section 327 may make application for assessment under the provisions of Section 328. This application, which must be attached to the corporation's return, must set forth in full (a) the reasons why the tax should be so determined; (b) the facts upon which such reasons are based; (c) an exact description of each trade or business or important branch of a trade or business carried on by it; (d) amount of invested capital and net income for each year from the beginning of the prewar period; (e) amount of gains, profits, commissions, or other income derived on a cost plus basis from Government contracts made after April 5, 1917, and before November 12, 1918, and the percentage which such income is of the total income of the corporation.

Determination by Commissioner.—The Commissioner will determine in each case as nearly as may be the group or class of corporations with which the corporation should be compared and the amount which bears the same ratio to the net income of the corporation (in excess of the specific exemption of $3,000) for the taxable year as the average tax of such representative corporations bears to their average net income (in excess of the specific exemption of $3,000) for such year. The comparison will take account of similarity with respect to gross income, net income, profit per unit of business transacted and capital employed, the amount and rate of war profits or excess profits, and all other relevant facts and circumstances.

First Installment of Tax.—In the case of any corporation, other than a foreign corporation, where absolutely no data are avail-

able for the determination of the invested capital for the taxable year, the installments of the tax shall in the first instance be determined upon the basis of a war profits and excess profits tax equal to 50%* of the net income. In any other case under Section 328 of the statute, other than the case of a foreign corporation, but including a case where the invested capital for the taxable year cannot be accurately determined, but where a minimum amount of invested capital as to which there is no question can be determined, the installments shall in the first instance be determined upon the basis of a war profits and excess profits tax computed by using the minimum invested capital, such tax not to exceed an amount equal to 50%* of the net income.

Foreign Corporation, Determination of First Installment.—In the case of a foreign corporation, the installments, of the tax shall in the first instance be determined upon the basis of a war profits and excess profits tax computed by using its invested capital for the taxable year 1917, such tax not to exceed an amount equal to 50%* of the net income. For the purpose of this article the invested capital for 1917 shall be adjusted for any subsequent changes in its amount due to cash or property paid in or withdrawn or to surplus or undivided profits of prior years retained in the business and properly attributable to its business within the United States. If the tax for 1917 was determined under Section 210 of the Revenue Act of 1917, the constructive capital which would result in a tax equivalent to the tax determined under that section shall be used.

Payment of Tax in Special Cases.—In the foregoing cases, the installments shall be paid upon the basis as indicated, until the Commissioner notifies the corporation of the amount of tax computed under Section 328. The installments shall then be recomputed upon the basis of a war profits and excess profits tax of such amount, and if the amount already paid is less than the amount which would have already become due if the installments had originally been computed upon that basis, the additional amount shall be due and payable ten days after notice and demand from the collector.

Credit.—The excess profits credit consists of the specific exemption of $3,000, plus an amount equal to 8 per centum of the invested capital for the taxable year. A foreign corporation is not entitled to the specific exemption of $3,000. Affiliated corporations making a

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* A ruling dated January 22, 1919, holds that, in claims for assessment under Sec. 328 for 1919, tax shall not exceed 40% of net income.

consolidated return are allowed but one specific exemption of $3,000. If any part of the excess profits credit is not allowed under the first bracket, because such credit is in excess of 20 per centum of the invested capital of the corporation, the balance thereof may be deducted from the amount of the income taxable in the second bracket.

The excess profits credit is used only in determining the excess profits tax. Where it is necessary to compute the war profits tax because of income derived from Government contracts, the computation should be made in accordance with Section 311 of Title III of the Revenue Act of 1918. See pages 175 and 176.

INVESTED CAPITAL

The computation of invested capital is based upon the cash or other property put into the business, plus the earned surplus and undivided profits, exclusive of earnings for the current taxable year, and is not affected by the present valuation or appraisal of the assets. Borrowed money or property, whether represented by bonds, notes, open accounts or otherwise, is specifically excluded. The fair market value of assets as of March 1, 1913, has no bearing on invested capital.

What Invested Capital Includes.—Invested capital, as defined in the taxing act of 1918, includes:

(1) Actual cash bona fide paid in for stock;

(2) Actual cash value at the time of payment, of tangible property bona fide paid in for stock but not in excess of the par value of stock issued therefor, unless such cash value is substantially in excess of the par value, in which case such excess shall be treated as paid in surplus;

(3) Paid-in or earned surplus and undivided profits, exclusive of earnings during the taxable year.

(4) Intangible property bona fide paid in for stock prior to March 3, 1917, not in excess of the lowest of the following three values:

(a) Actual cash value of the property when paid in,

(b) Par value of stock issued therefor, or

(c) In the aggregate, 25 per centum of the par value of the stock of the corporation, outstanding on March 3, 1917;

(5) Intangible property bona fide paid in for stock on or after March 3, 1917, not in excess of the lowest of the following three values:

(a) Actual cash value of property when paid in,

(b) Par value of stock issued therefor, or

(c) In the aggregate, 25 per centum of the par value of the stock of the corporation, outstanding at the beginning of the taxable year.

The total amount which may be included in invested capital on account of intangible property paid in for stock must not exceed, in the aggregate, 25 per centum of the par value of the stock of the corporation outstanding at the beginning of the taxable year.

Adjustment of Book Accounts and Other Measures of Value.—The invested capital, as determined by the taxing act, may differ from the capital as shown on the books of the corporation, but in such event, no changes should be made in the books themselves. The corporation should, however, in all cases, keep a permanent record of the adjustments which are made in computing invested capital in order that the taxpayer's books and the statement of invested capital may be reconciled.

The invested capital is based upon the actual investment of the stockholders in the corporation, irrespective of the present value of its assets. In the case of the capital stock tax imposed by Section 1000 of the 1918 law, the fair value looks to the present value of the corporation's assets, irrespective of the amount of the investment of the stockholders therein. Accordingly, the amount determined as the fair value of the capital stock for the purpose of the capital stock tax has no bearing upon the determination of invested capital.

Tangible and Intangible Property Defined.—Intangible property includes patents, copyrights, secret processes and formulæ, good will, trade-marks, trade-brands, franchises, and other like property. Tangible property means stocks, bonds, notes, and other evidences of indebtedness, bills and accounts receivable, leaseholds and property other than intangible property.

Most contracts are intangible property and in the absence of a specific ruling by the Commissioner to the contrary, should be so regarded for the purpose of making returns. Associated Press, United Press and similar franchises, and subscription lists and mailing lists, are intangible property under the regulations of the Department.

Tangible Property Paid In: Evidences of Indebtedness.—Enforcible notes or other evidences of indebtedness, whether interest-bearing or non-interest-bearing, of the subscriber received by a corporation upon a subscription for stock may be considered as tangible property in computing its invested capital to the extent of the actual cash value of such notes or other evidences of indebtedness at the time when paid in, but only if such notes or evidences of indebtedness could be legally received in pay-

ment for stock under the laws of the jurisdiction in which the corporation was organized, and if they were actually received by the corporation as absolute and not as conditional payment in whole or in part of the stock subscription.

Intangible Property Paid In.—The actual cash value of intangible property paid in for stock or shares must be determined in the light of the facts in each case. Among the factors to be considered are

(a) The earnings attributable to such intangible assets while in the hands of the predecessor owner;
(b) The earnings of the corporation attributable to the intangible assets after the date of their acquisition;
(c) Representative sales of the stock of the corporation at or about the date of the acquisition of the intangible assets; and,
(d) Any cash offers for the purchase of the business, including the intangible property, at or about the time of acquisition.

A corporation claiming a value for the intangible property paid in for stock or shares should file with its return a full statement of the facts relating to such valuation.

Mixed Tangible and Intangible Property.—If stock or shares, and bonds or other obligations have been issued for a mixed aggregate of tangible and intangible property, it will be presumed in the absence of satisfactory evidence to the contrary, that the bonds were issued for tangible property and that the stock was issued for the balance of the tangible property, if any, and for the intangible property. If stock or shares have been issued for a mixed aggregate of tangible and intangible property and certain liabilities have been assumed in connection with the transaction, it will be presumed that such liabilities are to be charged against the tangible property and the intangible property in the order named, unless it is shown by evidence satisfactory to the Commissioner that this presumption is not in accordance with the facts.

Where a mixed aggregate of tangible property and intangible property has been paid in for stock and bonds and the Commissioner is unable satisfactorily to determine the respective values of the several classes of property at the time of payment, or to distinguish the classes of property paid in for stock and for bonds, respectively, the tax shall be assessed under the provisions of Section 328.

Cash or Tangible Property Paid In.—Capital and surplus actually paid in cash for tangible property constitute invested capital at their value at the time when paid in.

Capital stock issued as a bonus in connection with the sale of a corporation's bonds may not be included in invested capital unless the corporation proves to the satisfaction of the Commissioner that such stock bonus enabled the corporation to secure a higher price for the bonds than it could otherwise have secured. Wherever this fact is established such stock may be included, in computing invested capital, to the extent of the difference between the selling price of the bonds and the price at which they could have been sold if issued without such stock bonus.

Tangible Property Paid In at Value in Excess of Par Value of Stock Issued Therefor.—Evidence offered to support a claim for a paid-in surplus must be as of the date of the payment and may consist, among other things, of

(a) An appraisal of the property by disinterested authorities made on or about the date of the transaction;

(b) Certification of the assessed value in the case of real estate; and

(c) Proof of a market price in excess of the par value of the stock or shares.

Additional value allowed in any case is limited to the value definitely known or accurately ascertainable at the time of the payment. No claim will be allowed for a paid-in surplus in a case in which the additional value has been developed or ascertained subsequently to the date when the property was paid in to the corporation or in respect of property which the stockholders or their agents on or shortly before the date of such payment acquired at a bargain price, as, for example, at a receiver's sale. Generally, allowable claims under this provision will arise out of transactions in which there has been no substantial change of beneficial interest in the property paid in to the corporation. In all cases the proof of value must be clear and explicit.

Paid-In Surplus.—Where satisfactory evidence is shown to the Commissioner that tangible property has been paid in by a stockholder to a corporation as a gift, or at a value definitely known or accurately ascertainable as of the date of such payment clearly and substantially in excess of the cash or other consideration paid by the corporation therefor, then the amount of the excess shall be deemed to be paid-in surplus. Substantially the same kind of evidence is required in this case as in the case of tangible property paid in for stock at a value in excess of the par value of the stock issued therefor.

Inadmissible Assets Paid In.—Stocks, bonds, and other obligations (other than obligations of the United States), the dividends or interest from which are not included in computing net income, hereafter described as inadmissible assets, when bona fide paid in for stock or shares, like other tangible property, may be included in computing the invested capital of the corporation at their actual cash value when paid in. For the purpose of the reduction required on account of inadmissible assets, however, account must be taken of such assets in the same manner as of any other inadmissible assets.

Impairment of Capital.—Except where there has been directly or indirectly a liquidation or return of investment to the stockholders, capital or surplus actually paid in is not required to be reduced because of an impairment of capital in the nature of an operating deficit. Thus, no deduction is necessary from capital and surplus paid in on account of a deficit due to losses, expense, depletion, depreciation or other causes. Before, however, its invested capital may be increased by surplus earnings or profits, the deficit must be made up.

Where, however, a corporation purchases its own stock, or where stock is surrendered by a stockholder, adjustment must be made to capital regardless of the existence of a surplus.

Property Paid In and Written Off.—If tangible or intangible property, which has been paid in to a corporation for stock or shares or as paid-in surplus, has been written off either wholly or in part, the amount so written off may be restored to capital or surplus account, upon evidence satisfactory to the Commissioner, except that

(1) The amount restored must be reduced by a proper deduction for any depreciation, obsolescence or depletion; and
(2) The aggregate amount included in computing invested capital on account of such property shall not exceed the amount which might have been included if such property had not been written off.

Current Earnings—Profits earned during the taxable year cannot be included in invested capital for such year. This is true even though, during the year, such profits are set up as surplus on the books or assumed to be distributed in the form of stock dividends. If a dividend is declared and paid during any year out of the profits of that year and the stockholders pay back into the corporation all or a substantial part of the amount of such dividends, the amount so paid back cannot be included in the computa-

tion of invested capital, unless the corporation shows by evidence satisfactory to the Commissioner that the dividends were paid in good faith and without any understanding, express or implied, that they were to be paid back.

Adjustment of Surplus and Undivided Profits.— The regulations provide that only true earned surplus and undivided profits can be included in the computation of invested capital, and if for any reason the books do not properly reflect the true surplus, such adjustments must be made as are necessary in order to arrive at the correct amount. In the computation of earned surplus and undivided profits full recognition must first be given to all expenses incurred and losses sustained from the original organization of the corporation down to the taxable year, including among such expenses and losses reasonable allowance for depreciation, obsolescence or depletion of property (irrespective of the manner in which such property was originally acquired), and for the amortization of any discount on its bonds. Where adequate evidence is presented that the amounts written off or deducted in previous returns of net income are in the aggregate incorrect or unreasonable, adjustments must be made, and the taxpayer will be allowed a refund in respect of any taxes overpaid in prior years, or, in the case of an underpayment of taxes, will be additionally assessed.

Depletion, like depreciation, must be recognized in all cases in which it occurs. Depletion attaches to each unit of mineral or other property removed, and the denial of a deduction in computing net income under the Act of August 5, 1909, or the limitation upon the amount of the deduction allowed under the Act of October 3, 1913, does not relieve the corporation of its obligation to make proper provision for depletion of its property in computing its surplus and undivided profits. Adjustments in respect of depreciation or depletion in prior years will be made or permitted only upon the basis of affirmative evidence that as at the beginning of the taxable year the amount of depreciation or depletion written off in prior years was insufficient or excessive, as the case may be. Where deductions for depreciation or depletion have either on the books of the corporation or in its returns of net income been included in the past in expense or other accounts, rather than specifically as depreciation or depletion, or where capital expenditures have been charged to expense in lieu of depreciation or depletion, a statement indicating the extent to which this practice has been carried should accompany the return.

Reserves in General.—Reserves which are not allowed as deductions in the corporation's income tax return, such as reserves for contingent losses, for bad debts, for market fluctuations in securities, and for similar purposes, may be included in invested capital. As actual deductions on account of the foregoing may be made only in the year in which sustained, they are charged against current earnings, and the amount of the reserve at the beginning of the year may form a part of the invested capital for the entire taxable year.

The reserve funds of insurance companies, the net additions to which are deductible from gross income under Section 234 of the law, cannot be included in computing invested capital.

Reserves for Depreciation and Depletion.—If reserves for depreciation or depletion are included in the surplus account, it should be analyzed so as to separate such reserves and leave only real surplus. The regulations provide that such reserves may be included in invested capital only, as follows:

(1) Excessive depletion or depreciation included therein and which if charged off could be restored to surplus under the regulations (Art. 840) may be included in the corporation's invested capital; and

(2) Where depreciation or depletion is computed on the value as of March 1, 1913, or as of any subsequent date, the proportion of depreciation or depletion representing the realization of appreciation of value at March 1, 1913, or such subsequent date, may, if undistributed and used or employed in the business be treated as surplus and included in the computation of invested capital.

Reserve for Income Tax.—Income and war profits and excess profits taxes are deemed to have been paid out of the net income of the taxable year for which levied. The effect of this ruling is to require a deduction from the invested capital, as of the beginning of the year, for such taxes, averaged for the proportionate part of the taxable year subsequent to the date upon which such taxes are due and payable.

If, for any reason, the amount of any such tax for the preceding year is subsequently changed, a corresponding adjustment will be made in the invested capital for the taxable year upon the same basis as if the corrected amount of the tax for the preceding year had been used in the original computation of the invested capital for the taxable year.

Additions to Surplus Account.—Although the books of a corporation will be presumed to show the facts, certain additions

to surplus and undivided profits are permitted under the regulations. The burden of proof, however, is upon the corporation claiming the additions to show that its capital or surplus account is understated. The regulations provide for the acceptance of additions to the following extent:

> (1) Excessive depreciation heretofore charged off on property still owned and in use, if it is now shown by satisfactory proof to have been excessive and such excess is substantial in amount, whether or not disallowed by the Commissioner as a deduction from net income, may be restored to the surplus account. No such amount shall be restored, however, unless it is shown that adequate depreciation has been deducted upon all other property of the corporation still in use, nor in any case in which such amount has been allowed as a deduction for amortization under paragraph 8, Section 234 (a) of the statute, or in which the cost of the property has been recovered through being included in the price of goods or services, as for example, in the case of patterns, dies, plates, special tools, etc., or under a munition contract with a foreign government.
>
> (2) Amounts which have been expended before January 1, 1917, for the acquisition of plant, equipment, tools, patterns, furniture, fixtures, or like tangible property, having a useful life extending substantially beyond the year in which the expenditure was made, and which have been charged as current expense, may (less proper deductions for depreciation or obsolescence) be added to the surplus account when such assets are still owned and in active use by the corporation during the taxable year. Special tools, patterns, and similar assets, shall not be assigned any value if their cost has been recovered through having been included in the price of goods. If their cost has not been so recovered and they are held for only occasional use, they shall not be assigned a value in excess of the fair value based upon the earnings actually arising from their current use, and in no case shall such value be more than the cost less depreciation. Assets of this kind not in current use shall not be valued at more than their nominal or scrap value.
>
> (3) Amounts which have been expended in the past for intangible property of any kind may be restored to capital or surplus account only to the extent that the corporation specifically paid such amounts for the intangible property as such.
>
> (4) Adjustments necessary to correct other errors found in the books of account may be made.

Limitations to Additions to Surplus Account.—Adjustments which are intended to correct returns of net income for prior years in which actual errors have been made, as for example, where excessive depreciation has been deducted, additions to plant and equipment, or other capital charges have been charged off as an expense, inventories have been taken upon a wrong basis of valuation, etc., will be permitted for all years, whether before or

after March 1, 1913, if amended returns of net income are filed for each year in which an erroneous return has been made.

A corporation cannot, however, reinstate in surplus account deductions from income which are as a matter of good accounting optional, such as experimental expenses, patent litigation, development of good will through advertising or otherwise, etc. In these cases it is considered that the corporation has exercised a binding option in deducting such expenses from income, and such an election, made concurrently with the transaction, cannot later be revised and amended returns accepted.

Patents.—Adjustment of surplus account on account of patents which have been acquired either for stock or shares, or for cash or other tangible property is made dependent to a large extent upon the manner in which the asset has been handled on the books of the corporation. The Department has laid down definite rules for the treatment of patents in Article 843 of Regulations 45.

Discount on Bonds, etc.—If, under incorrect accounting practices, discount allowed on the sale of bonds has been charged to a property account or otherwise carried as an asset, and is so reflected in the surplus account, it is necessary, in computing invested capital, to make an adjustment in respect of such discount.

Only the amount of discount which has actually been reported by a bank in a prior year as taxable income and credited to surplus account may be included in surplus as of the beginning of the taxable year.

Cash Value of Insurance on Officers, etc.—In case insurance is carried by a corporation on the life of an officer or employee, the policy may be included as an admissible asset and reflected in the surplus account at the cash surrender value at the beginning of the taxable year. Real or personal property taken by a corporation in payment or satisfaction of a debt, or property received in exchange for property, is an admissible asset at its fair market value upon receipt. The profit or loss, however, resulting from the transaction will not be reflected in invested capital until the succeeding taxable year.

Borrowed Capital Defined.—The law expressly excludes from invested capital all borrowed capital, which is defined in the law as money or other property borrowed, whether represented by bonds, notes, open accounts or otherwise. Any interest in a corporation represented by bonds, debentures or other securities, by

whatever name called, including so-called preferred stock, if with respect to the payment of either interest or principal it ranks with or prior to the interest of the general creditors, is borrowed capital and cannot be included in computing invested capital. Any such preferred stock may, however, be so included if it is deferred with respect to the payment of both interest and principal to the interest of the general creditors. Items such as deposits or amounts due to other banks shown in the balance sheet of a bank, unexpired subscriptions shown in the balance sheet of a publishing concern, etc., are deemed liabilities and cannot be included in computing invested capital.

The question often arises as to whether a given amount paid into or left in the business of a corporation represents borrowed capital or paid-in surplus. This is largely a question of fact. Indebtedness actually cancelled and left in the business would ordinarily constitute paid-in surplus, while amounts left in the business representing salaries of officers in excess of their actual withdrawals, or deposit accounts in favor of partners in a partnership succeeded by a corporation would be considered paid-in surplus or borrowed capital, according to the facts of the particular case. The general principle is that if interest is paid or is to be paid on any such amount, or if the stockholder's or officer's right to repayment of such amount ranks with or before that of the general creditors of the corporation, the amount so left with the corporation must be considered as borrowed capital and must be so treated in computing invested capital.

Inadmissible Assets Defined.—Stocks, bonds and other obligations (other than obligations of the United States), the dividends or interest from which are not required to be included in computing net income, are inadmissible assets, even though no such dividends or interest have been actually paid or received during the taxable year. The failure to pay or to receive dividends or interest does not change the status of such securities as inadmissible assets. A corporation cannot, by including the income from inadmissible assets as taxable income, create the right to have such assets considered admissible assets.

Obligations of a state or territory or any municipal or other political subdivision thereof, or the District of Columbia, or of any possession of the United States, and Federal reserve bank stock,

Federal Farm Loan bonds, and bonds of the War Finance Corporation up to $5,000 (the amount of principal the income from which is exempt from income and excess profits taxes), not being obligations of the United States within the meaning of the statute, are inadmissible assets. In case the income derived from inadmissible assets consists in part of profit from the disposition thereof, or where all or a part of the interest derived from such assets is in effect included in net income because the interest paid on indebtedness incurred or continued to purchase or carry such assets may not be deducted from gross income, in either case a corresponding part of the capital invested in such assets shall be deemed an admissible asset. The foregoing applies separately to each issue or class of inadmissible securities held by a corporation. For example, it may hold A company stock costing $100,000 and B company stock costing $200,000. During the year it receives $8,000 in dividends from A company and $5,000 from B company, and on September 30 sells part of its B company stock at a profit of $3,000. For the period from January 1 to September 30, $75,000 of its holdings of B company stock become admissible. After September 30, its remaining holdings of B company stock are inadmissible, but the proceeds of the sale are admissible, unless invested in inadmissibles.

Admissible Assets Defined.—Admissible assets include all assets other than inadmissible assets. Organization expenses and deferred charges against future income are admissible assets. For all purposes of computing invested capital, admissible assets must be valued in accordance with the provisions of Sections 326, 330 and 331 of the statute. Thus, for example, intangible property paid in for stock is an admissible asset, but it cannot be valued at an amount in excess of that at which it may be included in computing invested capital under paragraphs (4) and (5) of Section 326 (a).

Deduction on Account of Inadmissible Assets.—The 1918 law provides that there shall be deducted from invested capital as defined, after all adjustments to capital and surplus have been made, a percentage thereof equal to the percentage which the amount of the inadmissible assets is of the amount of admissible and inadmissible assets held during the taxable year. For example, take a corporation having assets and liabilities as follows:

(Corporation Balance Sheet December 31, 1918)

Assets		*Liabilities*	
Plant	$250,000	Capital Stock	
Inventory	175,000	(Paid in)	$150,000
Liberty Bonds	25,000	Surplus	25,000
State of N. Y.		Undivided Profits	25,000
Bonds	25,000	Notes Payable	200,000
Cash	25,000	Bills Payable	100,000
Total	$500,000	Total	$500,000

In the case of the above corporation, the capital, surplus and undivided profits amount to $200,000 which represents the invested capital of the corporation as defined in the law. Included in the assets of the corporation, however, are State bonds of the cost value of $25,000 which are inadmissible assets and constitute 5 per centum of the total assets of the corporation. The invested capital of $200,000 will, therefore, have to be reduced 5 per centum, leaving an invested capital of $190,000, which amount would be used in computing the tax.

In the above example, it is assumed that no adjustments must be made on account of intangible property paid in for stock, and that no part of the State bonds may be included in invested capital because of profits from dealing in the same.

For the purpose of ascertaining the deductible percentage, the amount of inadmissible assets held during the year may ordinarily be determined by dividing by two the sum of the amount of such assets at the beginning of the year and the amount held at the end of the year. The total amount of admissible and inadmissible assets held during the year may ordinarily be determined by dividing by two the sum of the amount of such assets held at the beginning of the year and the amount at the end of the year. If at any time a substantial change has taken place either in the amount of inadmissible assets or in the total amount of inadmissible and admissible assets, the effect of such change shall be averaged exactly from the date on which it occurred. In any case in which the Commissioner finds that either amount, determined as above provided, does not substantially reflect the average situation throughout the year, and that the amount of each kind of assets held on a given day of each month throughout the year or at more frequent regular intervals can be determined, the amount of inadmissible assets and the amount of both kinds of assets held during the year shall be determined by averaging the amounts held at such several times. In making these computations, the valuation at which each asset is carried shall be

adjusted in accordance with the provisions of the statute and of the regulations relating to the valuation of assets for the purpose of computing invested capital, including in such adjustment the amount of reserves for depreciation, depletion, amortization, and other reserves which represent the valuation of assets. It is immaterial whether any asset was acquired out of invested capital or out of profits earned during the year or borrowed capital.

Computation of Average Invested Capital.—For the purpose of computing invested capital for any period of one year or less, a corporation shall add together its paid-in capital and its paid-in or earned surplus and undivided profits (under whatever name it may be called) as shown by the books at the beginning of the period. The total so obtained shall be adjusted

(a) for any property paid in or for any asset reflected in surplus and undivided profits, which is not carried on the books at the valuation prescribed by the law or regulations, and

(b) for any changes in paid-in capital or in paid-in or earned surplus and undivided profits (not including surplus and undivided profits earned during the period) occurring during the period, averaged for the time for which such changes are effective.

The total so obtained and adjusted will be the average invested capital for the period, unless the corporation at any time during the period held any inadmissible assets, in which case such total must be reduced by a percentage thereof equal to the percentage which the amount of inadmissible assets held during the period is of the total amount of admissible and inadmissible assets held during the period. Invested capital cannot be determined by adding the amounts of the assets of the corporation.

In the case of a corporation making a return for the full year of twelve months, its invested capital for the year is the average invested capital for the year.

In the case of a corporation making a return for a fractional part of a year, its invested capital for such period is the same fractional part of the average invested capital for such period. In computing the tax under a return for a fractional part of a period, the same purpose may sometimes be more readily effected by using the full average invested capital and taking a fractional part of the result. For example: A corporation was organized July 1, 1919, and makes a return for the six months ending December 31, 1919. The invested capital consists of $100,000 paid in on July 1, and $100,000 paid in on October 1. The average invested capital for

such period would be $100,000 plus 92/184 (not 92/365) of $100,-000, or $50,000, a total of $150,000. The invested capital for the period for the purpose of the tax would, however, be 6/12 of $150,-000, or $75,000.

The invested capital as of the beginning of any period of one year or less should be adjusted by an appropriate addition or deduction, as the case may be, for each change in invested capital during the period. The amount so added or deducted in each case is the amount of the change averaged for the time remaining in the period during which it is in effect. The fraction used in finding such average is the number of days remaining in the period (including the day on which the change occurs) over the number of days in the period. Thus, if a return is made for the calendar year ending December 31, 1919, and if $100,000 of additional capital was paid in on February 17, 1919, this addition to invested capital is in effect for 318 days, and the amount to be added to the invested capital as of the beginning of the year would be 318/365 of $100,000, or $87,123.29. If $50,000 of this amount was withdrawn on October 31, 1919, the amount to be deducted would be 62/365 of $50,000, or $8,493.15.

Net Income Available for Dividends.—If dividends are paid from earnings of the taxable year, such payment does not affect the invested capital of the corporation. Whether at the time of any payment made during the taxable year there is sufficient income of the taxable year available for such payment, or whether the surplus or undivided profits as of the beginning of the taxable year must be reduced by the amount of such payment, shall be determined according to the following principles:

(1) The aggregate amount of earnings of the taxable year available for all purposes up to any given date will be determined upon the basis of the same proportion of the net income for the taxable year (as finally determined for the purpose of income and excess profits taxes) as the part of the year already elapsed is of the entire year, unless the corporation shows from its books or other records that a greater proportion of its earnings for the year was available on such date.

(2) The aggregate amount available will be deemed to be applied for the following purposes in the order in which they are stated:

(a) accrued Federal income and war profits and excess profits taxes for the taxable year, and

(b) dividends paid after the expiration of the first sixty days of the taxable year and other corporate purposes, including the purchase of outstanding stock of the corporation previously issued.

In any case where the above computation would be indeterminate because of the effect of these provisions upon the invested capital for the year, the amount of such invested capital for the purpose of this computation may be deemed to be the invested capital as of the beginning of the taxable year, plus any additional capital paid in during such year and minus any specific withdrawal or liquidation of capital during such year.

Payment of Ordinary Dividends.—A dividend other than a stock dividend affects the computation of invested capital from the date when the dividend is payable and not from the date when it is declared, except that where no date is set for its payment, the date when declared will be considered also the date when payable. For the purpose of computing invested capital a dividend paid after the expiration of the first sixty days of the taxable year will be deemed to be paid out of the net income of the taxable year to the extent of the net income available for such purpose on the date when it is payable. The surplus and undivided profits as of the beginning of the taxable year will be reduced as of the date when the dividend is payable by the entire amount of any dividend paid during the first sixty days of the taxable year and by the amount of any other dividend in excess of the current net income available for its payment.

In the case of a dividend paid during the first sixty days of a taxable year which exceeds in amount the surplus and undivided profits as of the beginning of the taxable year, the excess will be deemed to be paid out of earnings of the taxable year available at the date when the dividend is payable, and to the extent that such earnings are insufficient, it will be deemed to be a liquidation of paid-in capital or surplus. From the date when any dividend is payable, the amount which the several stockholders are entitled to receive will be treated as if actually paid to them, whether or not it is so paid in fact, and the surplus and undivided profits, either of the taxable year or of the preceding years, will in accordance with the foregoing provisions be deemed to be reduced as of that date by the full amount of the dividend. Amounts paid to stockholders in anticipation of dividends, or amounts withdrawn by stockholders in excess of dividends declared, will in computing invested capital, have the same effect as if actually paid as dividends.

Payment of Stock Dividends.—The payment of a stock dividend has no effect upon the amount of invested capital. Such items as appraised value of good will, appreciation in value of real

estate or other tangible property, etc., although carried to surplus and distributed as stock dividends, cannot in this manner be capitalized and included in computing invested capital. If a corporation has paid a stock dividend in excess of its true surplus, it cannot be deemed to have any greater invested capital than could have been computed had no such stock dividend been paid.

Surrender of Stock.—Where stock which has originally been issued or exchanged by the corporation for tangible or intangible property, is returned to it as a gift or for a consideration substantially less than its par value, the stock so returned shall not be treated as part of the stock issued or exchanged for such property. The proceeds derived in cash or its equivalent from resale of the stock thus returned shall, however, be included in computing invested capital.

Preparation of Consolidated Balance Sheet.—The invested capital of affiliated corporations required to make a consolidated return for the taxable year is the invested capital of the entire group treated as one unit operated under a common control. As a first step in the computation, a consolidated balance sheet should be prepared in accordance with standard accounting practices, which will reflect the actual assets and liabilities of the affiliated group. In preparing such a balance sheet all intercompany items, such as intercompany notes and accounts receivable and payable, should be eliminated from the assets and liabilities, respectively, and proper adjustments should be made in respect of intercompany profits or losses reflected in inventories which at the beginning or end of the taxable year contain merchandise exchanged between the corporations included in the affiliated group at prices above or below cost to the producing or original owner corporation. Such consolidated balance sheet will then show:

(a) The capital stock of the parent or principal company in the hands of the public;

(b) The consolidated surplus belonging to the stockholders of the parent or principal company; and

(c) The capital stock, if any, of subsidiary companies not owned by the parent or principal company, together with surplus, if any, belonging to such minority interest.

In computing consolidated invested capital the starting point is furnished by the total of the amounts shown under (a), (b) and (c) above. This total must be increased or diminished by any adjust-

ments required to be made by way of additions or deductions, as heretofore explained.

Stock of Subsidiary Acquired for Cash or Stock.—When all or substantially all of the stock of a subsidiary corporation was acquired for cash, the cash so paid shall be the basis to be used in determining the value of the property acquired. If stock of a subsidiary company was acquired with the stock of the parent company, the amount to be included in the consolidated invested capital in respect of the company acquired shall be computed in the same manner as if the net tangible assets and the intangible assets had been acquired instead of the stock. If, in accordance with such acquisition a paid-in surplus is claimed, such claim shall be subject to all of the requirements necessary to establish a paid-in surplus in other cases.

Intangible Property Paid In.—In the case of corporations whose affiliation is in the nature of parent and subsidiary companies—

(a) If intangible property was bona fide, paid in for stock prior to March 3, 1917, there may be included in invested capital an amount not exceeding the actual cash value of such property at the time paid in, or the par value of the stock or shares issued therefor, or in the aggregate 25 per centum of the par value of the total stock or shares of the consolidation outstanding on March 3, 1917, or in the aggregate 25 per centum of the par value of the total stock or shares shown in the consolidated balance sheet at the beginning of the taxable year, whichever is lowest; and

(b) If intangible property was bona fide paid in for stock or shares on or after March 3, 1917, there may be included in invested capital an amount not exceeding the actual cash value of such property at the time paid in, or the par value of the stock or shares issued therefor, or in the aggregate 25 per centum of the par value of the total stock shown in the consolidated balance sheet to be outstanding at the beginning of the taxable year, whichever is lowest; and

(c) If intangible property has been acquired in part before and in part after March 3, 1917, the amounts shall be ascertained, respectively, under (a) and (b) above and in the aggregate shall in no case exceed 25 per centum of the par value of the total stock or shares outstanding at the beginning of the taxable year shown in the consolidated balance sheet.

In the case of corporations affiliated by reason of ownership by the same interests, the limitations set forth in paragraphs (4) and (5) of subdivision (a) of Section 326 of the statute shall be applied to each corporation separately and the aggregate of the intangible property, as valued, shall be included in invested capital in the con-

solidated return. In respect of each of the affiliated corporations, the aggregate of the amounts ascertained under the provisions of paragraphs (4) and (5) of Section 326 shall in no case exceed 25 per centum of the outstanding capital stock of such corporation at the beginning of the taxable year.

Foreign Corporations.—Inasmuch as the excess profits tax in the case of a foreign corporation is not based on its invested capital, but is computed in accordance with Section 328 of the law,* the provisions of Section 326 do not apply to such corporations. Accordingly, in rendering a return of income on Form 1120, a foreign corporation should make no entry of invested capital.

Valuation of Assets upon Change of Ownership.—Where a business is reorganized, consolidated, or transferred, or property is transferred after March 3, 1917, and an interest of 50 per centum, or greater, in such business or property remains in any of the previous owners, then for the purpose of determining the invested capital each asset so transferred is valued

(a) as if still in the possession of the previous owner, if a corporation, or, if not a corporation,

(b) at its cost to such owner, with proper adjustments for losses and improvements.

RETURNS

Every corporation, domestic or foreign, which is not specifically exempt from tax is required to file a return for the purpose of the excess profits tax on Form 1120, if based on the calendar year, or Form 1120-A, if based on a fiscal year ending in 1919. Returns shall be made, and the taxes paid, at the same time and places, in the same manner, and subject to the same conditions, as is provided in the case of returns and payments of income tax by corporations, and all the provisions of Title II of the law not inapplicable, including penalties, are made applicable to excess profits taxes.

Fiscal Years Ending in 1919.—The method provided for computing the tax for a fiscal year beginning in 1918 and ending in 1919 is as follows:

(a) The tax attributable to the calendar year 1918 is found by computing the income of the taxpayer and the tax thereon in accordance with the statute as if the fiscal year was the calendar year 1918, and determining the proportion of such tax which the

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* See page 179.

number of months falling within the calendar year 1918 is of the number of months in the entire period;

(b) The tax attributable to the calendar year 1919 is found by computing the income of the taxpayer and the tax thereon in accordance with the statute as if the fiscal year was the calendar year 1919, and determining the proportion of such tax which the number of months falling within the calendar year 1919 is of the number of months in the entire period; and

(c) The tax for the fiscal year is found by adding the tax attributable to the calendar year 1918 and the tax attributable to the calendar year 1919.

PART V. TEXT OF REVENUE ACT OF 1918

TITLE I.—GENERAL DEFINITIONS

SECTION 1. That when used in this Act—

The term "person" includes partnerships and corporations, as well as individuals;

The term "corporation" includes associations, joint-stock companies, and insurance companies;

The term "domestic" when applied to a corporation or partnership means created or organized in the United States;

The term "foreign" when applied to a corporation or partnership means created or organized outside the United States;

The term "United States" when used in a geographical sense includes only the States, the Territories of Alaska and Hawaii, and the District of Columbia;

The term "Secretary" means the Secretary of the Treasury;

The term "Commissioner" means the Commissioner of Internal Revenue;

The term "collector" means collector of internal revenue;

The term "Revenue Act of 1916" means the Act entitled "An Act to increase the revenue, and for other purposes," approved September 8, 1916;

The term "Revenue Act of 1917" means the Act entitled "An Act to provide revenue to defray war expenses, and for other purposes," approved October 3, 1917;

The term "taxpayer" includes any person, trust or estate subject to a tax imposed by this Act;

The term "Government contract" means (a) a contract made with the United States, or with any department, bureau, officer, commission, board, or agency, under the United States and acting in its behalf, or with any agency controlled by any of the above if the contract is for the benefit of the United States, or (b) a subcontract made with a contractor performing such a contract if the products or services to be furnished under the subcontract are for the benefit of the United States.

The term "Government contract or contracts made between April 6, 1917, and November 11, 1918, both dates inclusive" when applied to a contract of the kind referred to in clause (a) of this paragraph, includes all such contracts which, although entered into during such period, were originally not enforceable, but which have been or may become enforceable by reason of subsequent validation in pursuance of law;

The term "military or naval forces of the United States" includes the Marine Corps, the Coast Guard, the Army Nurse Corps, Female, and the Navy Nurse Corps, Female, but this shall not be deemed to exclude other units otherwise included within such term;

The term "present war" means the war in which the United States is now engaged against the German Government.

For the purposes of this Act the date of the termination of the present war shall be fixed by proclamation of the President.

TITLE II.—INCOME TAX

PART I.—GENERAL PROVISIONS

DEFINITIONS

SEC. 200. That when used in this title—

The term "taxable year" means the calendar year, or the fiscal year ending during such calendar year, upon the basis of which the net income is computed under section 212 or section 232. The term "fiscal year" means an accounting period of twelve months ending on the last day of any month other than December. The first taxable year, to be called the taxable year 1918, shall be the calendar year 1918 or any fiscal year ending during the calendar year 1918;

The term "fiduciary" means a guardian, trustee, executor, administrator, receiver, conservator, or any person acting in any fiduciary capacity for any person, trust or estate;

The term "withholding agent" means any person required to deduct and withhold any tax under the provisions of section 221 or section 237;

The term "personal service corporation" means a corporation whose income is to be ascribed primarily to the activities of the principal owners or stockholders who are themselves regularly engaged in the active conduct of the affairs of the corporation and in which capital (whether invested or borrowed) is not a material income-producing factor; but does not include any foreign corporation, nor any corporation 50 per centum or more of whose gross income consists either (1) of gains, profits or income derived from trading as a principal, or (2) of gains, profits, commissions or other income, derived from a Government contract or contracts made between April 6, 1917, and November 11, 1918, both dates inclusive;

The term "paid," for the purposes of the deductions and credits under this title, means "paid or accrued" or "paid or incurred," and the terms "paid or incurred" and "paid or accrued" shall be construed according to the method of accounting upon the basis of which the net income is computed under section 212.

DIVIDENDS

SEC. 201.(a) That the term "dividend" when used in this title (except in paragraph (10) of subdivision (a) of section 234) means (1) any distribution made by a corporation, other than a personal service corporation, to its shareholders or members, whether in cash or in other property or in stock of the corporation, out of its earnings or profits accumulated since February 28, 1913, or (2) any such distribution made by a personal service corporation out of its earnings or profits accumulated since February 28, 1913, and prior to January 1, 1918.

(b) Any distribution shall be deemed to have been made from earnings or profits unless all earnings and profits have first been distributed. Any distribution made in the year 1918 or any year thereafter shall be deemed to have been made from earnings or profits accumulated since February 28, 1913, or, in the case of a personal service corporation, from the most recently accumulated earnings or profits; but any earnings or profits accumulated prior to March 1, 1913, may be distributed in stock dividends or otherwise, exempt from the tax, after the earnings and profits accumulated since February 28, 1913, have been distributed.

(c) A dividend paid in stock of the corporation shall be considered income to the amount of the earnings or profits distributed. Amounts distributed in the liquidation of a corporation shall be treated as payments in exchange for stock or shares, and any gain or profit realized thereby shall be taxed to the distributee as other gains or profits.

(d) If any stock dividend (1) is received by a taxpayer between January 1 and November 1, 1918, both dates inclusive, or (2) is during such period bona fide authorized or declared, and entered on the books of the corporation, and is received by a taxpayer after November 1, 1918, and before the expiration of thirty days after the passage of this Act, then such dividend shall, in the manner provided in section 206, be taxed to the recipient at the rates prescribed by law for the years in which the corporation accumulated the earnings or profits from which such dividend was paid, but the dividend shall be deemed to have been paid from the most recently accumulated earnings or profits.

(e) Any distribution made during the first sixty days of any taxable year shall be deemed to have been made from earnings or profits accumulated during preceding taxable years; but any distribution made during the remainder of the taxable year shall be deemed to have been made from earnings or profits accumulated between the close of the preceding taxable year and the date of distribution, to the extent of such earnings or profits, and if the books of the corporation do not show the amount of such earnings or profits, the earnings or profits for the accounting period within which the distribution was made shall be deemed to have been accumulated ratably during such period.

BASIS FOR DETERMINING GAIN OR LOSS

SEC. 202.(a) That for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, the basis shall be—

(1) In the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date; and

(2) In the case of property acquired on or after that date, the cost thereof; or the inventory value, if the inventory is made in accordance with section 203.

(b) When property is exchanged for other property, the property received in exchange shall for the purpose of determining gain or loss be treated as the equivalent of cash to the amount of its fair market value, if any; but when in connection with the reorganization, merger, or consolidation of a corporation a person receives in place of stock or securities owned by him new stock or securities of no greater aggregate par or face value, no gain or loss shall be deemed to occur from

the exchange, and the new stock or securities received shall be treated as taking the place of the stock, securities, or property exchanged.

When in the case of any such reorganization, merger or consolidation the aggregate par or face value of the new stock or securities received is in excess of the aggregate par or face value of the stock or securities exchanged, a like amount in par or face value of the new stock or securities received shall be treated as taking the place of the stock or securities exchanged, and the amount of the excess in par or face value shall be treated as a gain to the extent that the fair market value of the new stock or securities is greater than the cost (or if acquired prior to March 1, 1913, the fair market value as of that date) of the stock or securities exchanged.

INVENTORIES

SEC. 203. That whenever in the opinion of the Commissioner the use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such taxpayer upon such basis as the Commissioner, with the approval of the Secretary, may prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income.

NET LOSSES

SEC. 204.(a) That as used in this section the term "net loss" refers only to net losses resulting from either (1) the operation of any business regularly carried on by the taxpayer, or (2) the bona fide sale by the taxpayer of plant, buildings, machinery, equipment or other facilities, constructed, installed or acquired by the taxpayer on or after April 6, 1917, for the production of articles contributing to the prosecution of the present war; and when so resulting means the excess of the deductions allowed by law (excluding in the case of corporations amounts allowed as a deduction under paragraph (6) of subdivision (a) of section 234) over the sum of the gross income plus any interest received free from taxation both under this title and under Title III.

(b) If for any taxable year beginning after October 31, 1918 and ending prior to January 1, 1920, it appears upon the production of evidence satisfactory to the Commissioner that any taxpayer has sustained a net loss, the amount of such net loss shall under regulations prescribed by the Commissioner with the approval of the Secretary be deducted from the net income of the taxpayer for the preceding taxable year; and the taxes imposed by this title and by Title III for such preceding taxable year shall be redetermined accordingly. Any amount found to be due to the taxpayer upon the basis of such redetermination shall be credited or refunded to the taxpayer in accordance with the provisions of section 252. If such net loss is in excess of the net income for such preceding taxable year, the amount of such excess shall under regulations prescribed by the Commissioner with the approval of the Secretary be allowed as a deduction in computing the net income for the succeeding taxable year.

(c) The benefit of this section shall be allowed to the members of a partnership and the beneficiaries of an estate or trust under regulations prescribed by the Commissioner with the approval of the Secretary.

FISCAL YEAR WITH DIFFERENT RATES

SEC. 205.(a) That if a taxpayer makes return for a fiscal year beginning in 1917 and ending in 1918, his tax under this title for the first taxable year shall be the sum of: (1) the same proportion of a tax for the entire period computed under Title I of the Revenue Act of 1916 as amended by the Revenue Act of 1917 and under Title I of the Revenue Act of 1917, which the portion of such period falling within the calendar year 1917 is of the entire period, and (2) the same proportion of a tax for the entire period computed under this title at the rates for the calendar year 1918 which the portion of such period falling within the calendar year 1918 is of the entire period: *Provided*, That in the case of a personal service corporation the amount to be paid shall be only that specified in clause (1).

Any amount heretofore or hereafter paid on account of the tax imposed for such fiscal year by Title I of the Revenue Act of 1916 as amended by the Revenue Act of 1917, and by Title I of the Revenue Act of 1917, shall be credited towards the payment of the tax imposed for such fiscal year by this act, and if the amount so paid exceeds the amount of such tax imposed by this act, or, in the case of a personal service corporation, the amount specified in clause (1), the excess shall be credited or refunded in accordance with the provisions of section 252.

(b) If a taxpayer makes a return for a fiscal year beginning in 1918 and ending in 1919, the tax under this title for such fiscal year shall be the sum of: (1) the same proportion of a tax for the entire period computed under this title at the rates specified for the calendar year 1918 which the portion of such period falling within the calendar year 1918 is of the entire period, and (2) the same proportion of a tax for the entire period computed under this title at the rates specified for the calendar year 1919 which the portion of such period falling within the calendar year 1919 is of the entire period.

(c) If a fiscal year of a partnership begins in 1917 and ends in 1918 or begins in 1918 and ends in 1919, then notwithstanding the provisions of subdivision (b) of section 218, (1) the rates for the calendar year during which such fiscal year begins shall apply to an amount of each partner's share of such partnership net income (determined under the law applicable to such year) equal to the proportion which the part of such fiscal year falling within such calendar year bears to the full fiscal year, and (2) the rates for the calendar year during which such fiscal year ends shall apply to an amount of each partner's share of such partnership net income (determined under the law applicable to such calendar year) equal to the proportion which the part of such fiscal year falling within such calendar year bears to the full fiscal year: *Provided*, That in the case of a personal service corporation with respect to a fiscal year beginning in 1917 and ending in 1918, the amount specified in clause (1) shall not be subject to normal tax.

PARTS OF INCOME SUBJECT TO RATES FOR DIFFERENT YEARS

SEC. 206. That whenever parts of a taxpayer's income are subject to rates for different calendar years, the part subject to the rates for the most recent calendar year shall be placed in the lower brackets of

the rate schedule provided in this title, the part subject to the rates for the next preceding calendar year shall be placed in the next higher brackets of the rate schedule applicable to that year, and so on until the entire net income has been accounted for. In determining the income, any deductions, exemptions or credits of a kind not plainly and properly chargeable against the income taxable at rates for a preceding year shall first be applied against the income subject to rates for the most recent calendar year; but any balance thereof shall be applied against the income subject to the rates of the next preceding year or years until fully allowed.

PART II.—INDIVIDUALS

NORMAL TAX

SEC. 210. That, in lieu of the taxes imposed by subdivision (a) of section 1 of the Revenue Act of 1916 and by section 1 of the Revenue Act of 1917, there shall be levied, collected, and paid for each taxable year upon the net income of every individual a normal tax at the following rates:

(a) For the calendar year 1918, 12 per centum of the amount of the net income in excess of the credits provided in section 216: *Provided,* That in the case of a citizen or resident of the United States the rate upon the first $4,000 of such excess amount shall be 6 per centum;

(b) For each calendar year thereafter, 8 per centum of the amount of the net income in excess of the credits provided in section 216: *Provided,* That in the case of a citizen or resident of the United States the rate upon the first $4,000 of such excess amount shall be 4 per centum.

SURTAX

SEC. 211.(a) That, in lieu of the taxes imposed by subdivision (b) of section 1 of the Revenue Act of 1916 and by section 2 of the Revenue Act of 1917, but in addition to the normal tax imposed by section 210 of this Act, there shall be levied, collected, and paid for each taxable year upon the net income of every individual, a surtax equal to the sum of the following:

1 per centum of the amount by which the net income exceeds $5,000 and does not exceed $6,000;

2 per centum of the amount by which the net income exceeds $6,000 and does not exceed $8,000;

3 per centum of the amount by which the net income exceeds $8,000 and does not exceed $10,000;

4 per centum of the amount by which the net income exceeds $10,000 and does not exceed $12,000;

5 per centum of the amount by which the net income exceeds $12,000 and does not exceed $14,000;

6 per centum of the amount by which the net income exceeds $14,000 and does not exceed $16,000;

7 per centum of the amount by which the net income exceeds $16,000 and does not exceed $18,000;

8 per centum of the amount by which the net income exceeds $18,000 and does not exceed $20,000;

9 per centum of the amount by which the net income exceeds $20,000 and does not exceed $22,000;

10 per centum of the amount by which the net income exceeds $22,000 and does not exceed $24,000;

11 per centum of the amount by which the net income exceeds $24,000 and does not exceed $26,000;

12 per centum of the amount by which the net income exceeds $26,000 and does not exceed $28,000;

13 per centum of the amount by which the net income exceeds $28,000 and does not exceed $30,000;

14 per centum of the amount by which the net income exceeds $30,000 and does not exceed $32,000;

15 per centum of the amount by which the net income exceeds $32,000 and does not exceed $34,000;

16 per centum of the amount by which the net income exceeds $34,000 and does not exceed $36,000;

17 per centum of the amount by which the net income exceeds $36,000 and does not exceed $38,000;

18 per centum of the amount by which the net income exceeds $38,000 and does not exceed $40,000;

19 per centum of the amount by which the net income exceeds $40,000 and does not exceed $42,000;

20 per centum of the amount by which the net income exceeds $42,000 and does not exceed $44,000;

21 per centum of the amount by which the net income exceeds $44,000 and does not exceed $46,000;

22 per centum of the amount by which the net income exceeds $46,000 and does not exceed $48,000;

23 per centum of the amount by which the net income exceeds $48,000 and does not exceed $50,000;

24 per centum of the amount by which the net income exceeds $50,000 and does not exceed $52,000;

25 per centum of the amount by which the net income exceeds $52,000 and does not exceed $54,000;

26 per centum of the amount by which the net income exceeds $54,000 and does not exceed $56,000;

27 per centum of the amount by which the net income exceeds $56,000 and does not exceed $58,000;

28 per centum of the amount by which the net income exceeds $58,000 and does not exceed $60,000;

29 per centum of the amount by which the net income exceeds $60,000 and does not exceed $62,000;

30 per centum of the amount by which the net income exceeds $62,000 and does not exceed $64,000;

31 per centum of the amount by which the net income exceeds $64,000 and does not exceed $66,000;

32 per centum of the amount by which the net income exceeds $66,000 and does not exceed $68,000;

33 per centum of the amount by which the net income exceeds $68,000 and does not exceed $70,000;

34 per centum of the amount by which the net income exceeds $70,000 and does not exceed $72,000;

35 per centum of the amount by which the net income exceeds $72,000 and does not exceed $74,000;
36 per centum of the amount by which the net income exceeds $74,000 and does not exceed $76,000;
37 per centum of the amount by which the net income exceeds $76,000 and does not exceed $78,000;
38 per centum of the amount by which the net income exceeds $78,000 and does not exceed $80,000;
39 per centum of the amount by which the net income exceeds $80,000 and does not exceed $82,000;
40 per centum of the amount by which the net income exceeds $82,000 and does not exceed $84,000;
41 per centum of the amount by which the net income exceeds $84,000 and does not exceed $86,000;
42 per centum of the amount by which the net income exceeds $86,000 and does not exceed $88,000;
43 per centum of the amount by which the net income exceeds $88,000 and does not exceed $90,000;
44 per centum of the amount by which the net income exceeds $90,000 and does not exceed $92,000;
45 per centum of the amount by which the net income exceeds $92,000 and does not exceed $94,000;
46 per centum of the amount by which the net income exceeds $94,000 and does not exceed $96,000;
47 per centum of the amount by which the net income exceeds $96,000 and does not exceed $98,000;
48 per centum of the amount by which the net income exceeds $98,000 and does not exceed $100,000;
52 per centum of the amount by which the net income exceeds $100,000 and does not exceed $150,000;
56 per centum of the amount by which the net income exceeds $150,000 and does not exceed $200,000;
60 per centum of the amount by which the net income exceeds $200,000 and does not exceed $300,000;
63 per centum of the amount by which the net income exceeds $300,000 and does not exceed $500,000;
64 per centum of the amount by which the net income exceeds $500,000 and does not exceed $1,000,000;
65 per centum of the amount by which the net income exceeds $1,000,000.

(b) In the case of a bona fide sale of mines, oil or gas wells, or any interest therein, where the principal value of the property has been demonstrated by prospecting or exploration and discovery work done by the taxpayer, the portion of the tax imposed by this section attributable to such sale shall not exceed 20 per centum of the selling price of such property or interest.

NET INCOME DEFINED

SEC. 212.(a) That in the case of an individual the term "net income" means the gross income as defined in section 213, less the deductions allowed by section 214.

(b) The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made upon such basis and in such manner as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 200 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year.

If a taxpayer changes his accounting period from fiscal year to calendar year, or from calendar year to fiscal year, or from one fiscal year to another, the net income shall, with approval of the Commissioner, be computed on the basis of such new accounting period, subject to the provisions of section 226.

GROSS INCOME DEFINED

SEC. 213. That for the purposes of this title (except as otherwise provided in section 233) the term "gross income"—

(a) Includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including in the case of the President of the United States, the judges of the Supreme and inferior courts of the United States, and all other officers and employees, whether elected or appointed, of the United States, Alaska, Hawaii, or any political subdivision thereof, or the District of Columbia, the compensation received as such), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. The amount of all such items shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under subdivision (b) of section 212, any such amounts are to be properly accounted for as of a different period; but

(b) Does not include the following items, which shall be exempt from taxation under this title:

(1) The proceeds of life insurance policies paid upon the death of the insured to individual beneficiaries or to the estate of the insured;

(2) The amount received by the insured as a return of premium or premiums paid by him under life insurance, endowment, or annuity contracts, either during the term or at the maturity of the term mentioned in the contract or upon surrender of the contract;

(3) The value of property acquired by gift, bequest, devise, or descent (but the income from such property shall be included in gross income);

(4) Interest upon (a) the obligations of a State, Territory, or any political subdivision thereof, or the District of Columbia; or (b) securities issued under the provisions of the Federal Farm Loan Act of July

17, 1916; or (c) the obligations of the United States or its possessions; or (d) bonds issued by the War Finance Corporation: *Provided*, That every person owning any of the obligations, securities or bonds enumerated in clauses (a), (b), (c), and (d) shall, in the return required by this title, submit a statement showing the number and amount of such obligations, securities and bonds owned by him and the income received therefrom, in such form and with such information as the Commissioner may require. In the case of obligations of the United States issued after September 1, 1917, and in the case of bonds issued by the War Finance Corporation, the interest shall be exempt only if and to the extent provided in the respective Acts authorizing the issue thereof as amended and supplemented, and shall be exeluded from gross income only if and to the extent it is wholly exempt from taxation to the taxpayer both under this title and under Title III;

(5) The income of foreign governments received from investments in the United States in stocks, bonds, or other domestic securities, owned by such foreign governments, or from interest on deposits in banks in the United States of moneys belonging to such foreign governments, or from any other source within the United States;

(6) Amounts received, through accident or health insurance or under workmen's compensation acts, as compensation for personal injuries or sickness, plus the amount of any damages received whether by suit or agreement on account of such injuries or sickness;

(7) Income derived from any public utility or the exercise of any essential governmental function and accruing to any State, Territory, or the District of Columbia, or any political subdivision of a State or Territory, or income accruing to the government of any possession of the United States, or any political subdivision thereof.

Whenever any State, Territory, or the District of Columbia, or any political subdivision of a State or Territory, prior to September 8, 1916, entered in good faith into a contract with any person, the object and purpose of which is to acquire, construct, operate, or maintain a public utility, no tax shall be levied under the provisions of this title upon the income derived from the operation of such public utility, so far as the payment thereof will impose a loss or burden upon such State, Territory, District of Columbia, or political subdivision; but this provision is not intended to confer upon such person any financial gain or exemption or to relieve such person from the payment of a tax as provided for in this title upon the part or portion of such income to which such person is entitled under such contract;

(8) So much of the amount received during the present war by a person in the military or naval forces of the United States as salary or compensation in any form from the United States for active services in such forces, as does not exceed $3,500.

(c) In the case of nonresident alien individuals, gross income includes only the gross income from sources within the United States, including interest on bonds, notes, or other interest-bearing obligations of residents, corporate or otherwise, dividends from resident corporations, and including all amounts received (although paid under a contract for the sale of goods or otherwise) representing profits on the manufacture and disposition of goods within the United States.

DEDUCTIONS ALLOWED

SEC. 214. (a) That in computing net income there shall be allowed as deductions:

(1) All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered, and including rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity;

(2) All interest paid or accrued within the taxable year on indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities (other than obligations of the United States issued after September 24, 1917), the interest upon which is wholly exempt from taxation under this title as income to the taxpayer, or, in the case of a nonresident alien individual, the proportion of such interest which the amount of his gross income from sources within the United States bears to the amount of his gross income from all sources within and without the United States;

(3) Taxes paid or accrued within the taxable year imposed (a) by the authority of the United States, except income, war-profits and excess-profits taxes; or (b) by the authority of any of its possessions, except the amount of income, war-profits and excess-profits taxes allowed as a credit under section 222; or (c) by the authority of any State or Territory, or any county, school district, municipality, or other taxing subdivision of any State or Territory, not including those assessed against local benefits of a kind tending to increase the value of the property assessed; or (d) in the case of a citizen or resident of the United States, by the authority of any foreign country, except the amount of income, war-profits and excess-profits taxes allowed as a credit under section 222; or (e) in the case of a nonresident alien individual, by the authority of any foreign country (except income, war-profits and excess-profits taxes, and taxes assessed against local benefits of a kind tending to increase the value of the property assessed), upon property or business;

(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in trade or business;

(5) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit, though not connected with the trade or business; but in the case of a nonresident alien individual only as to such transactions within the United States;

(6) Losses sustained during the taxable year of property not connected with the trade or business (but in the case of a nonresident alien individual only property within the United States) if arising from fires, storms, shipwreck, or other casualty, or from theft, and if not compensated for by insurance or otherwise;

(7) Debts ascertained to be worthless and charged off within the taxable year;

(8) A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence;

(9) In the case of buildings, machinery, equipment, or other facilities, constructed, erected, installed, or acquired, on or after April 6, 1917, for the production of articles contributing to the prosecution of the present war, and in the case of vessels constructed or acquired on or after such date for the transportation of articles or men contributing to the prosecution of the present war, there shall be allowed a reasonable deduction for the amortization of such part of the cost of such facilities or vessels as has been borne by the taxpayer, but not again including any amount otherwise allowed under this title or previous Acts of Congress as a deduction in computing net income. At any time within three years after the termination of the present war, the Commissioner may, and at the request of the taxpayer shall, reexamine the return, and if he then finds as a result of an appraisal or from other evidence that the deduction originally allowed was incorrect, the taxes imposed by this title and by Title III for the year or years affected shall be redetermined; and the amount of tax due upon such redetermination, if any, shall be paid upon notice and demand by the collector, or the amount of tax overpaid, if any, shall be credited or refunded to the taxpayer in accordance with the provisions of section 252;

(10) In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case, based upon cost including cost of development not otherwise deducted: *Provided*, That in the case of such properties acquired prior to March 1, 1913, the fair market value of the property (or the taxpayer's interest therein) on that date shall be taken in lieu of cost up to that date: *Provided further*, That in the case of mines, oil and gas wells, discovered by the taxpayer, on or after March 1, 1913, and not acquired as the result of purchase of a proven tract or lease, where the fair market value of the property is materially disproportionate to the cost, the depletion allowance shall be based upon the fair market value of the property at the date of the discovery, or within thirty days thereafter; such reasonable allowance in all the above cases to be made under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary. In the case of leases the deductions allowed by this paragraph shall be equitably apportioned between the lessor and lessee;

(11) Contributions or gifts made within the taxable year to corporations organized and operated exclusively for religious, charitable, scientific, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual, or to the special fund for vocational rehabilitation authorized by section 7 of the Vocational Rehabilitation Act, to an amount not in excess of 15 per centum of the taxpayer's net income as computed without the benefit of this paragraph. Such contributions or gifts shall be allowable as deductions only if verified under rules and regulations prescribed by the Commissioner, with the approval of the Secretary. In the case of a nonresident alien individual this deduction shall be allowed only as to contributions or gifts made to domestic corporations, or to such vocational rehabilitation fund;

(12) (a) At the time of filing return for the taxable year 1918 a taxpayer may file a claim in abatement based on the fact that he has sustained a substantial loss (whether or not actually realized by sale or other disposition) resulting from any material reduction (not due to temporary fluctuation) of the value of the inventory for such taxable year, or from the actual payment after the close of such taxable year of rebates in pursuance of contracts entered into during such year upon sales made during such year. In such case payment of the amount of the tax covered by such claim shall not be required until the claim is decided, but the taxpayer shall accompany his claim with a bond in double the amount of the tax covered by the claim, with sureties satisfactory to the Commissioner, conditioned for the payment of any part of such tax found to be due, with interest. If any part of such claim is disallowed then the remainder of the tax due shall on notice and demand by the collector be paid by the taxpayer with interest at the rate of 1 per centum per month from the time the tax would have been due had no such claim been filed. If it is shown to the satisfaction of the Commissioner that such substantial loss has been sustained, then in computing the tax imposed by this title the amount of such loss shall be deducted from the net income. (b) If no such claim is filed, but it is shown to the satisfaction of the Commissioner that during the taxable year 1919 the taxpayer has sustained a substantial loss of the character above described then the amount of such loss shall be deducted from the net income for the taxable year 1918 and the tax imposed by this title for such year shall be redetermined accordingly. Any amount found to be due to the taxpayer upon the basis of such redetermination shall be credited or refunded to the taxpayer in accordance with the provisions of section 252.

(b) In the case of a nonresident alien individual the deductions allowed in paragraphs (1), (4), (7), (8), (9), (10), (12), and clause (e) of paragraph (3), of subdivision (a) shall be allowed only if and to the extent that they are connected with income arising from a source within the United States; and the proper apportionment and allocation of the deductions with respect to sources of income within and without the United States shall be determined under rules and regulations prescribed by the Commissioner with the approval of the Secretary.

ITEMS NOT DEDUCTIBLE

SEC. 215. That in computing net income no deduction shall in any case be allowed in respect of—

(a) Personal, living, or family expenses;

(b) Any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate;

(c) Any amount expended in restoring property or in making good the exhaustion thereof for which an allowance is or has been made; or

(d) Premiums paid on any life insurance policy covering the life of any officer or employee, or of any person financially interested in any trade or business carried on by the taxpayer, when the taxpayer is directly or indirectly a beneficiary under such policy.

CREDITS ALLOWED

SEC. 216. That for the purpose of the normal tax only there shall be allowed the following credits:

(a) The amount received as dividends from a corporation which is taxable under this title upon its net income, and amounts received as dividends from a personal service corporation out of earnings or profits upon which income tax has been imposed by Act of Congress;

(b) The amount received as interest upon obligations of the United States and bonds issued by the War Finance Corporation, which is included in gross income under section 213;

(c) In the case of a single person, a personal exemption of $1,000, or in the case of the head of a family or a married person living with husband or wife, a personal exemption of $2,000. A husband and wife living together shall receive but one personal exemption of $2,000 against their aggregate net income; and in case they make separate returns, the personal exemption of $2,000 may be taken by either or divided between them;

(d) $200 for each person (other than husband or wife) dependent upon and receiving his chief support from the taxpayer, if such dependent person is under eighteen years of age or is incapable of self-support because mentally or physically defective;

(e) In the case of a nonresident alien individual who is a citizen or subject of a country which imposes an income tax, the credits allowed in subdivisions (c) and (d) shall be allowed only if such country allows a similar credit to citizens of the United States not residing in such country.

NONRESIDENT ALIENS—ALLOWANCE OF DEDUCTIONS AND CREDITS

SEC. 217. That a nonresident alien individual shall receive the benefit of the deductions and credits allowed in this title only by filing or causing to be filed with the collector a true and accurate return of his total income received from all sources corporate or otherwise in the United States, in the manner prescribed by this title, including therein all the information which the Commissioner may deem necessary for the calculation of such deductions and credits: *Provided*, That the benefit of the credits allowed in subdivisions (c) and (d) of section 216 may, in the discretion of the Commissioner, and except as otherwise provided in subdivision (e) of that section, be received by filing a claim therefor with the withholding agent. In case of failure to file a return, the collector shall collect the tax on such income, and all property belonging to such nonresident alien individual shall be liable to distraint for the tax.

PARTNERSHIPS AND PERSONAL SERVICE CORPORATIONS

SEC. 218.(a) That individuals carrying on business in partnership shall be liable for income tax only in their individual capacity. There shall be included in computing the net income of each partner his distributive share, whether distributed or not, of the net income of the partnership for the taxable year, or, if his net income for such taxable year is computed upon the basis of a period different from that upon

the basis of which the net income of the partnership is computed, then his distributive share of the net income of the partnership for any accounting period of the partnership ending within the fiscal or calendar year upon the basis of which the partner's net income is computed.

The partner shall, for the purpose of the normal tax, be allowed as credits, in addition to the credits allowed to him under section 216, his proportionate share of such amounts specified in subdivisions (a) and (b) of section 216 as are received by the partnership.

(b) If a fiscal year of a partnership ends during a calendar year for which the rates of tax differ from those for the preceding calendar year, then (1) the rates for such preceding calendar year shall apply to an amount of each partner's share of such partnership net income equal to the proportion which the part of such fiscal year falling within such calendar year bears to the full fiscal year, and (2) the rates for the calendar year during which such fiscal year ends shall apply to the remainder.

(c) In the case of an individual member of a partnership which makes return for a fiscal year beginning in 1917 and ending in 1918, his proportionate share of any excess profits tax imposed upon the partnership under the Revenue Act of 1917 with respect to that part of such fiscal year falling in 1917, shall, for the purpose of determining the tax imposed by this title, be credited against that portion of the net income embraced in his personal return for the taxable year 1918 to which the rates for 1917 apply.

(d) The net income of the partnership shall be computed in the same manner and on the same basis as provided in section 212 except that the deduction provided in paragraph (11) of subdivision (a) of section 214 shall not be allowed.

(e) Personal service corporations shall not be subject to taxation under this title, but the individual stockholders thereof shall be taxed in the same manner as the members of partnerships. All the provisions of this title relating to partnerships and the members thereof shall so far as practicable apply to personal service corporations and the stockholders thereof: *Provided*, That for the purpose of this subdivision amounts distributed by a personal service corporation during its taxable year shall be accounted for by the distributees; and any portion of the net income remaining undistributed at the close of its taxable year shall be accounted for by the stockholders of such corporation at the close of its taxable year in proportion to their respective shares.

ESTATES AND TRUSTS

SEC. 219.(a) That the tax imposed by section 210 and 211 shall apply to the income of estates or of any kind of property held in trust, including—

(1) Income received by estates of deceased persons during the period of administration or settlement of the estate;

(2) Income accumulated in trust for the benefit of unborn or unascertained persons or persons with contingent interests;

(3) Income held for future distribution under the terms of the will or trust; and

(4) Income which is to be distributed to the beneficiaries periodically, whether or not at regular intervals, and the income collected by a guardian of an infant to be held or distributed as the court may direct.

(b) The fiduciary shall be responsible for making the return of income for the estate or trust for which he acts. The net income of the estate or trust shall be computed in the same manner and on the same basis as provided in section 212, except that there shall also be allowed as a deduction (in lieu of the deduction authorized by paragraph (11) of subdivision (a) of section 214) any part of the gross income which, pursuant to the terms of the will or deed creating the trust, is during the taxable year paid to or permanently set aside for the United States, any State, Territory, or any political subdivision thereof, or the District of Columbia, or any corporation organized and operated exclusively for religious, charitable, scientific, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual; and in cases under paragraph (4) of subdivision (a) of this section the fiduciary shall include in the return a statement of each beneficiary's distributive share of such net income, whether or not distributed before the close of the taxable year for which the return is made.

(c) In cases under paragraph (1), (2), or (3) of subdivision (a) the tax shall be imposed upon the net income of the estate or trust and shall be paid by the fiduciary, except that in determining the net income of the estate of any deceased person during the period of administration or settlement there may be deducted the amount of any income properly paid or credited to any legatee, heir or other beneficiary. In such cases the estate or trust shall, for the purpose of the normal tax, be allowed the same credits as are allowed to single persons under section 216.

(d) In cases under paragraph (4) of subdivision (a), and in the case of any income of an estate during the period of administration or settlement permitted by subdivision (c) to be deducted from the net income upon which tax is to be paid by the fiduciary, the tax shall not be paid by the fiduciary, but there shall be included in computing the net income of each beneficiary his distributive share, whether distributed or not, of the net income of the estate or trust for the taxable year, or, if his net income for such taxable year is computed upon the basis of a period different from that upon the basis of which the net income of the estate or trust is computed, then his distributive share of the net income of the estate or trust for any accounting period of such estate or trust ending within the fiscal or calendar year upon the basis of which such beneficiary's net income is computed. In such cases the beneficiary shall, for the purpose of the normal tax, be allowed as credits in addition to the credits allowed to him under section 216, his proportionate share of such amounts specified in subdivisions (a) and (b) of section 216 as are received by the estate or trust.

PROFITS OF CORPORATIONS TAXABLE TO STOCKHOLDERS

SEC. 220. That if any corporation, however created or organized, is formed or availed of for the purpose of preventing the imposition of the surtax upon its stockholders or members through the medium of

permitting its gains and profits to accumulate instead of being divided or distributed, such corporation shall not be subject to the tax imposed by section 230, but the stockholders or members thereof shall be subject to taxation under this title in the same manner as provided in subdivision (e) of section 218 in the case of stockholders of a personal service corporation, except that the tax imposed by Title III shall be deducted from the net income of the corporation before the computation of the proportionate share of each stockholder or member. The fact that any corporation is a mere holding company, or that the gains and profits are permitted to accumulate beyond the reasonable needs of the business, shall be prima facie evidence of a purpose to escape the surtax; but the fact that the gains and profits are in any case permitted to accumulate and become surplus shall not be construed as evidence of a purpose to escape the tax in such case unless the Commissioner certifies that in his opinion such accumulation is unreasonable for the purposes of the business. When requested by the Commissioner, or any collector, every corporation shall forward to him a correct statement of such gains and profits and the names and addresses of the individuals or shareholders who would be entitled to the same if divided or distributed, and of the amounts that would be payable to each.

PAYMENT OF TAX AT SOURCE

SEC. 221.(a) That all individuals, corporations and partnerships, in whatever capacity acting, including lessees or mortgagors of real or personal property, fiduciaries, employers, and all officers and employees of the United States, having the control, receipt, custody, disposal, or payment, of interest, rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable annual or periodical gains, profits, and income, of any nonresident alien individual (other than income received as dividends from a corporation which is taxable under this title upon its net income) shall (except in the cases provided for in subdivision (b) and except as otherwise provided in regulations prescribed by the Commissioner under section 217) deduct and withhold from such annual or periodical gains, profits, and income a tax equal to 8 per centum thereof: *Provided*, That the Commissioner may authorize such tax to be deducted and withheld from the interest upon any securities the owners of which are not known to the withholding agent.

(b) In any case where bonds, mortgages, or deeds of trust, or other similar obligations of a corporation contain a contract or provisions by which the obligor agrees to pay any portion of the tax imposed by this title upon the obligee, or to reimburse the obligee for any portion of the tax, or to pay the interest without deduction for any tax which the obligor may be required or permitted to pay thereon or to retain therefrom under any law of the United States, the obligor shall deduct and withhold a tax equal to 2 per centum of the interest upon such bonds, mortgages, deeds of trust, or other obligations, whether such interest is payable annually or at shorter or longer periods and whether payable to a nonresident alien individual or to an individual citizen or resident of the United States or to a partnership: *Provided*, That the Commissioner may authorize such tax to be deducted and withheld in the case

of interest upon any such bonds, mortgages, deeds of trust or other obligations, the owners of which are not known to the withholding agent. Such deduction and withholding shall not be required in the case of a citizen or resident entitled to receive such interest, if he files with the withholding agent on or before February 1, a signed notice in writing claiming the benefit of the credits provided in subdivisions (c) and (d) of section 216; nor in the case of a nonresident alien individual if so provided for in regulations prescribed by the Commissioner under section 217.

(c) Every individual, corporation, or partnership required to deduct and withhold any tax under this section shall make return thereof on or before March first of each year and shall on or before June fifteenth pay the tax to the official of the United States Government authorized to receive it. Every such individual, corporation, or partnership is hereby made liable for such tax and is hereby indemnified against the claims and demands of any individual, corporation, or partnership for the amount of any payments made in accordance with the provisions of this section.

(d) Income upon which any tax is required to be withheld at the source under this section shall be included in the return of the recipient of such income, but any amount of tax so withheld shall be credited against the amount of income tax as computed in such return.

(e) If any tax required under this section to be deducted and withheld is paid by the recipient of the income, it shall not be re-collected from the withholding agent; nor in cases in which the tax is so paid shall any penalty be imposed upon or collected from the recipient of the income or the withholding agent for failure to return or pay the same, unless such failure was fraudulent and for the purpose of evading payment.

CREDIT FOR TAXES

SEC. 222.(a) That the tax computed under Part II of this title shall be credited with:

(1) In the case of a citizen of the United States, the amount of any income, war-profits and excess-profits taxes paid during the taxable year to any foreign country, upon income derived from sources therein, or to any possession of the United States; and

(2) In the case of a resident of the United States, the amount of any such taxes paid during the taxable year to any possession of the United States; and

(3) In the case of an alien resident of the United States who is a citizen or subject of a foreign country, the amount of any such taxes paid during the taxable year to such country, upon income derived from sources therein, if such country, in imposing such taxes, allows a similar credit to citizens of the United States residing in such country; and

(4) In the case of any such individual who is a member of a partnership or a beneficiary of an estate or trust, his proportionate share of such taxes of the partnership or the estate or trust paid during the taxable year to a foreign country or to any possession of the United States, as the case may be.

(b) If accrued taxes when paid differ from the amounts claimed as credits by the taxpayer, or if any tax paid is refunded in whole or in part, the taxpayer shall notify the Commissioner who shall redetermine the amount of the tax due under Part II of this title for the year or years affected, and the amount of tax due upon such redetermination, if any, shall be paid by the taxpayer upon notice and demand by the collector, or the amount of tax overpaid, if any, shall be credited or refunded to the taxpayer in accordance with the provisions of section 252. In the case of such a tax accrued but not paid, the Commissioner as a condition precedent to the allowance of this credit may require the taxpayer to give a bond with sureties satisfactory to and to be approved by the Commissioner in such penal sum as the Commissioner may require, conditioned for the payment by the taxpayer of any amount of tax found due upon any such redetermination; and the bond herein prescribed shall contain such further conditions as the Commissioner may require.

(c) These credits shall be allowed only if the taxpayer furnishes evidence satisfactory to the Commissioner showing the amount of income derived from sources within such foreign country or such possession of the United States, and all other information necessary for the computation of such credits.

INDIVIDUAL RETURNS

Sec. 223. That every individual having a net income for the taxable year of $1,000 or over if single or if married and not living with husband or wife, or of $2,000 or over if married and living with husband or wife, shall make under oath a return stating specifically the items of his gross income and the deductions and credits allowed by this title. If a husband and wife living together have an aggregate net income of $2,000 or over, each shall make such a return unless the income of each is included in a single joint return.

If the taxpayer is unable to make his own return, the return shall be made by a duly authorized agent or by the guardian or other person charged with the care of the person or property of such taxpayer.

PARTNERSHIP RETURNS

Sec. 224. That every partnership shall make a return for each taxable year, stating specifically the items of its gross income and the deductions allowed by this title, and shall include in the return the names and addresses of the individuals who would be entitled to share in the net income if distributed and the amount of the distributive share of each individual. The return shall be sworn to by any one of the partners.

FIDUCIARY RETURNS

Sec. 225. That every fiduciary (except receivers appointed by authority of law in possession of part only of the property of an individual) shall make under oath a return for the individual, estate or trust for which he acts (1) if the net income of such individual is $1,000 or over if single or if married and not living with husband or wife, or $2,000 or over if married and living with husband or wife, or (2) if the

net income of such estate or trust is $1,000 or over or if any beneficiary of such estate or trust is a nonresident alien, stating specifically the items of the gross income and the deductions and credits allowed by this title. Under such regulations as the Commissioner with the approval of the Secretary may prescribe, a return made by one of two or more joint fiduciaries and filed in the office of the collector of the district where such fiduciary resides shall be a sufficient compliance with the above requirement. The fiduciary shall make oath that he has sufficient knowledge of the affairs of such individual, estate or trust to enable him to make the return, and that the same is, to the best of his knowledge and belief, true and correct.

Fiduciaries required to make returns under this Act shall be subject to all the provisions of this Act which apply to individuals.

RETURNS WHEN ACCOUNTING PERIOD CHANGED

SEC. 226. That if a taxpayer, with the approval of the Commissioner, changes the basis of computing net income from fiscal year to calendar year a separate return shall be made for the period between the close of the last fiscal year for which return was made and the following December 31. If the change is from calendar year to fiscal year, a separate return shall be made for the period between the close of the last calendar year for which return was made and the date designated as the close of the fiscal year. If the change is from one fiscal year to another fiscal year a separate return shall be made for the period between the close of the former fiscal year and the date designated as the close of the new fiscal year. If a taxpayer making his first return for income tax keeps his accounts on the basis of a fiscal year he shall make a separate return for the period between the beginning of the calendar year in which such fiscal year ends and the end of such fiscal year.

In all of the above cases the net income shall be computed on the basis of such period for which separate return is made, and the tax shall be paid thereon at the rate for the calendar year in which such period is included; and the credits provided in subdivisions (c) and (d) of section 216 shall be reduced respectively to amounts which bear the same ratio to the full credits provided in such subdivisions as the number of months in such period bears to twelve months.

TIME AND PLACE FOR FILING RETURNS

(SEC. 227.(a) That returns shall be made on or before the fifteenth day of the third month following the close of the fiscal year, or if the return is made on the basis of the calendar year, then the return, shall be made on or before the fifteenth day of March. The Commissioner may grant a reasonable extension of time for filing returns whenever in his judgment good cause exists and shall keep a record of every such extension and the reason therefor. Except in the case of taxpayers who are abroad, no such extension shall be for more than six months.

(b) Returns shall be made to the collector for the district in which is located the legal residence or principal place of business of the person making the return, or, if he has no legal residence or principal place of business in the United States, then to the collector at Baltimore. Maryland.

UNDERSTATEMENT IN RETURNS

SEC. 228. That if the collector or deputy collector has reason to believe that the amount of any income return is understated, he shall give due notice to the taxpayer making the return to show cause why the amount of the return should not be increased, and upon proof of the amount understated, may increase the same accordingly. Such taxpayer may furnish sworn testimony to prove any relevant facts and if dissatisfied with the decision of the collector may appeal to the Commissioner for his decision, under such rules of procedure as may be prescribed by the Commissioner with the approval of the Secretary.

PART III.—CORPORATIONS

TAX ON CORPORATIONS

SEC. 230.(a) That, in lieu of the taxes imposed by section 10 of the Revenue Act of 1916, as amended by the Revenue Act of 1917, and by section 4 of the Revenue Act of 1917, there shall be levied, collected, and paid for each taxable year upon the net income of every corporation a tax at the following rates:

(1) For the calendar year 1918, 12 per centum of the amount of the net income in excess of the credits provided in section 236; and

(2) For each calendar year thereafter, 10 per centum of such excess amount.

(b) For the purposes of the Act approved March 21, 1918, entitled "An Act to provide for the operation of transportation systems while under Federal control, for the just compensation of their owners, and for other purposes," five-sixths of the tax imposed by paragraph (1) of subdivision (a) and four-fifths of the tax imposed by paragraph (2) of subdivision (a) shall be treated as levied by an Act in amendment of Title I of the Revenue Act of 1917.

CONDITIONAL AND OTHER EXEMPTIONS

SEC. 231. That the following organizations shall be exempt from taxation under this title—

(1) Labor, agricultural, or horticultural organizations;

(2) Mutual savings banks not having a capital stock represented by shares;

(3) Fraternal beneficiary societies, orders, or associations, (a) operating under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system, and (b) providing for the payment of life, sick, accident, or other benefits to the members of such society, order, or association or their dependents;

(4) Domestic building and loan associations and cooperative banks without capital stock organized and operated for mutual purposes and without profit;

(5) Cemetery companies owned and operated exclusively for the benefit of their members;

(6) Corporations organized and operated exclusively for religious, charitable, scientific, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual.

(7) Business leagues, chambers of commerce, or boards of trade, not organized for profit and no part of the net earnings of which inures to the benefit of any private stockholder or individual;

(8) Civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare;

(9) Clubs organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, no part of the net earnings of which inures to the benefit of any private stockholder or member;

(10) Farmers' or other mutual hail, cyclone, or fire insurance companies, mutual ditch or irrigation companies, mutual or cooperative telephone companies, or like organizations of a purely local character, the income of which consists solely of assessments, dues, and fees collected from members for the sole purpose of meeting expenses;

(11) Farmers', fruit growers', or like associations, organized and operated as sales agents for the purpose of marketing the products of members and turning back to them the proceeds of sales, less the necessary selling expenses, on the basis of the quantity of produce furnished by them;

(12) Corporations organized for the exclusive purpose of holding title to property, collecting income therefrom, and turning over the entire amount thereof, less expenses, to an organization which itself is exempt from the tax imposed by this title;

(13) Federal land banks and national farm-loan associations as provided in section 26 of the act approved July 17, 1916, entitled "An Act to provide capital for agricultural development, to create standard forms of investment based upon farm mortgage, to equalize rates of interest upon farm loans, to furnish a market for United States bonds, to create Government depositaries and financial agents for the United States, and for other purposes";

(14) Personal service corporations.

NET INCOME DEFINED

Sec. 232. That in the case of a corporation subject to the tax imposed by section 230 the term "net income" means the gross income as defined in section 233 less the deductions allowed by section 234, and the net income shall be computed on the same basis as is provided in subdivision (b) of section 212 or in section 226.

GROSS INCOME DEFINED

Sec. 233.(a) That in the case of a corporation subject to the tax imposed by section 230 the term "gross income" means the gross income as defined in section 213, except that:

(1) In the case of life insurance companies there shall not be included in gross income such portion of any actual premium received from any individual policyholder as is paid back or credited to or treated as an abatement of premium of such policyholder within the taxable year.

(2) Mutual marine insurance companies shall include in gross income the gross premiums collected and received by them less amounts paid for reinsurance.

(b) In the case of a foreign corporation gross income includes only the gross income from sources within the United States, including the interest on bonds, notes, or other interest-bearing obligations of residents, corporate or otherwise, dividends from resident corporations, and including all amounts received (although paid under a contract for the sale of goods or otherwise) representing profits on the manufacture and disposition of goods within the United States.

DEDUCTIONS ALLOWED

Sec. 234.(a) That in computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:

(1) All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered, and including rentals or other payments required to be made as a condition to the continued use or possession of property to which the corporation has not taken or is not taking title, or in which it has no equity;

(2) All interest paid or accrued within the taxable year on its indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities (other than obligations of the United States issued after September 24, 1917) the interest upon which is wholly exempt from taxation under this title as income to the taxpayer, or, in the case of a foreign corporation, the proportion of such interest which the amount of its gross income from sources within the United States bears to the amount of its gross income from all sources within and without the United States;

(3) Taxes paid or accrued within the taxable year imposed (a) by the authority of the United States, except income, war-profits and excess-profits taxes; or (b) by the authority of any of its possessions, except the amount of income, war-profits and excess-profits taxes allowed as a credit under section 238; or (c) by the authority of any State or Territory, or any county, school district, municipality, or other taxing subdivision of any State or Territory, not including those assessed against local benefits of a kind tending to increase the value of the property assessed; or (d) in the case of a domestic corporation, by the authority of any foreign country, except the amount of income, war-profits and excess-profits taxes allowed as a credit under section 238; or (e) in the case of a foreign corporation, by the authority of any foreign country (except income, war-profits and excess-profits taxes, and taxes assessed against local benefits of a kind tending to increase the value of the property assessed), upon the property or business: *Provided*, That in the case of obligors specified in subdivision (b) of section 221 no deduction for the payment of the tax imposed by this title or any other tax paid pursuant to the contract or provision referred to in that subdivision, shall be allowed;

(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise;

(5) Debts ascertained to be worthless and charged off within the taxable year;

(6) Amounts received as dividends from a corporation which is taxable under this title upon its net income, and amounts received as dividends from a personal service corporation out of earnings or profits upon which income tax has been imposed by Act of Congress;

(7) A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence;

(8) In the case of buildings, machinery, equipment, or other facilities, constructed, erected, installed, or acquired, on or after April 6, 1917, for the production of articles contributing to the prosecution of the present war, and in the case of vessels constructed or acquired on or after such date for the transportation of articles or men contributing to the prosecution of the present war, there shall be allowed a reasonable deduction for the amortization of such part of the cost of such facilities or vessels as has been borne by the taxpayer, but not again including any amount otherwise allowed under this title or previous acts of Congress as a deduction in computing net income. At any time within three years after the termination of the present war the Commissioner may, and at the request of the taxpayer shall, reexamine the return, and if he then finds as a result of an appraisal or from other evidence that the deduction originally allowed was incorrect, the taxes imposed by this title and by Title III for the year or years affected shall be redetermined and the amount of tax due upon such redetermination, if any, shall be paid upon notice and demand by the collector, or the amount of tax overpaid, if any, shall be credited or refunded to the taxpayer in accordance with the provisions of section 252;

(9) In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case, based upon cost including cost of development not otherwise deducted: *Provided*, That in the case of such properties acquired prior to March 1, 1913, the fair market value of the property (or the taxpayer's interest therein) on that date shall be taken in lieu of cost up to that date: *Provided further*, That in the case of mines, oil and gas wells, discovered by the taxpayer, on or after March 1, 1913, and not acquired as the result of purchase of a proven tract or lease, where the fair market value of the property is materially disproportionate to the cost, the depletion allowance shall be based upon the fair market value of the property at the date of the discovery, or within thirty days thereafter; such reasonable allowance in all the above cases to be made under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary. In the case of leases the deductions allowed by this paragraph shall be equitably apportioned between the lessor and lessee;

(10) In the case of insurance companies, in addition to the above: (a) The net addition required by law to be made within the taxable year to reserve funds (including in the case of assessment insurance companies the actual deposit of sums with State or Territorial officers pursuant to law as additions to guarantee or reserve funds); and (b) the sums other than dividends paid within the taxable year on policy and annuity contracts;

(11) In the case of corporations issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan continuing for life and not subject to cancellation, in addition to the above, such portion of the net addition (not required by law) made within the taxable year to reserve funds as the Commissioner finds to be required for the protection of the holders of such policies only;

(12) In the case of mutual marine insurance companies, there shall be allowed, in addition to the deductions allowed in paragraphs (1) to (10), inclusive, amounts repaid to policyholders on account of premiums previously paid by them, and interest paid upon such amounts between the ascertainment and the payment thereof;

(13) In the case of mutual insurance companies (other than mutual life or mutual marine insurance companies) requiring their members to make premium deposits to provide for losses and expenses, there shall be allowed, in addition to the deductions allowed in paragraphs (1) to (10), inclusive, (unless otherwise allowed under such paragraphs) the amount of premium deposits returned to their policyholders and the amount of premium deposits retained for the payment of losses, expenses, and reinsurance reserves;

(14) (a) At the time of filing return for the taxable year 1918 a taxpayer may file a claim in abatement based on the fact that he has sustained a substantial loss (whether or not actually realized by sale or ther disposition) resulting from any material reduction (not due to temporary fluctuation) of the value of the inventory for such taxable year, or from the actual payment after the close of such taxable year of rebates in pursuance of contracts entered into during such year upon sales made during such year. In such case payment of the amount of the tax covered by such claim shall not be required until the claim is decided, but the taxpayer shall accompany his claim with a bond in double the amount of the tax covered by the claim, with sureties satisfactory to the Commissioner, conditioned for the payment of any part of such tax found to be due, with interest. If any part of such claim is disallowed then the remainder of the tax due shall on notice and demand by the collector be paid by the taxpayer with interest at the rate of 1 per centum per month from the time the tax would have been due had no such claim been filed. If it is shown to the satisfaction of the Commissioner that such substantial loss has been sustained, then in computing the taxes imposed by this title and by Title III the amount of such loss shall be deducted from the net income. (b) If no such claim is filed, but it is shown to the satisfaction of the Commissioner that during the taxable year 1919 the taxpayer has sustained a substantial loss of the character above described then the amount of such loss shall be deducted from the net income for the taxable year 1918 and the taxes imposed by this title and by Title III for such year shall be redetermined accordingly. Any amount found to be due to the taxpayer upon the basis of such redetermination shall be credited or refunded to the taxpayer in accordance with the provisions of section 252.

(b) In the case of a foreign corporation the deductions allowed in subdivision (a), except those allowed in paragraph (2) and in clauses (a), (b), and (c) of paragraph (3), shall be allowed only if and to the extent

that they are connected with income arising from a source within the United States; and the proper apportionment and allocation of the deductions with respect to sources of income within and without the United States shall be determined under rules and regulations prescribed by the Commissioner with the approval of the Secretary.

ITEMS NOT DEDUCTIBLE

SEC. 235. That in computing net income no deduction shall in any case be allowed in respect of any of the items specified in section 215.

CREDITS ALLOWED

SEC. 236. That for the purpose only of the tax imposed by section 230 there shall be allowed the following credits:

(a) The amount received as interest upon obligations of the United States and bonds issued by the War Finance Corporation, which is included in gross income under section 233;

(b) The amount of any taxes imposed by Title III for the same taxable year: *Provided*, That in the case of a corporation which makes return for a fiscal year beginning in 1917 and ending in 1918, in computing the tax as provided in subdivision (a) of section 205, the tax computed for the entire period under Title II of the Revenue Act of 1917 shall be credited against the net income computed for the entire period under Title I of the Revenue Act of 1916 as amended by the Revenue Act of 1917 and under Title I of the Revenue Act of 1917, and the tax computed for the entire period under Title III of this Act at the rates prescribed for the calendar year 1918 shall be credited against the net income computed for the entire period under this title; and

(c) In the case of a domestic corporation, $2,000.

PAYMENT OF TAX AT SOURCE

SEC. 237. That in the case of foreign corporations subject to taxation under this title not engaged in trade or business within the United States and not having any office or place of business therein, there shall be deducted any withheld at the source in the same manner and upon the same items of income as is provided in section 221 a tax equal to 10 per centum thereof, and such tax shall be returned and paid in the same manner and subject to the same conditions as provided in that section: *Provided*, That in the case of interest described in subdivision (b) of that section the deduction and withholding shall be at the rate of 2 per centum.

CREDIT FOR TAXES

SEC. 238.(a) That in the case of a domestic corporation the total taxes imposed for the taxable year by this title and by Title III shall be credited with the amount of any income, war-profits and excess-profits taxes paid during the taxable year to any foreign country, upon income derived from sources therein, or to any possession of the United States.

If accrued taxes when paid differ from the amounts claimed as credits by the corporation, or if any tax paid is refunded in whole or in part, the corporation shall at once notify the Commissioner who shall redetermine the amount of the taxes due under this title and under Title III for the year or years affected, and the amount of taxes due upon such redeter-

mination, if any, shall be paid by the corporation upon notice and demand by the collector, or the amount of taxes overpaid, if any, shall be credited or refunded to the corporation in accordance with the provisions of section 252. In the case of such a tax accrued but not paid, the Commissioner as a condition precedent to the allowance of this credit may require the corporation to give a bond with sureties satisfactory to and to be approved by him in such penal sum as he may require, conditioned for the payment by the taxpayer of any amount of taxes found due upon any such redetermination; and the bond herein prescribed shall contain such further conditions as the Commissioner may require.

(b) This credit shall be allowed only if the taxpayer furnishes evidence satisfactory to the Commissioner showing the amount of income derived from sources within foreign country or such possession of the. United States, as the case may be, and all other information necessary for the computation of such credit.

(c) If a domestic corporation makes a return for a fiscal year beginning in 1917 and ending in 1918, only that proportion of this credit shall be allowed which the part of such period within the calendar year 1918 bears to the entire period.

CORPORATION RETURNS

SEC. 239. That every corporation subject to taxation under this title and every personal service corporation shall make a return, stating specifically the items of its gross income and the deductions and credits allowed by this title. The return shall be sworn to by the president, vice-president, or other principal officer and by the treasurer or assistant treasurer. If any foreign corporation has no office or place of business in the United States but has an agent in the United States, the return shall be made by the agnet. In cases where receivers, trustees in bankruptcy, or assignees are operating the property or business of corporations, such receivers, trustees, or assignees shall make returns for such corporations in the same manner and form as corporations are required to make returns. Any tax due on the basis of such returns made by receivers, trustees, or assignees shall be collected in the same manner as if collected from the corporations of whose business or property they have custody and control.

Returns made under this section shall be subject to the provisions of sections 226 and 228.

When return is made under section 226 the credit provided in subdivision (c) of section 236 shall be reduced to an amount which bears the same ratio to the full credit therein provided as the number of months in the period for which such return is made bears to twelve months.

CONSOLIDATED RETURNS

SEC. 240.(a) That corporations which are affiliated within the meaning of this section shall, under regulations to be prescribed by the Commissioner with the approval of the Secretary, make a consolidated return of net income and invested capital for the purposes of this title and Title III, and the taxes thereunder shall be computed and determined upon

the basis of such return: *Provided,* That there shall be taken out of such consolidated net income and invested capital, the net income and invested capital of any such affiliated corporation organized after August 1, 1914, and not successor to a then existing business, 50 per centum or more of whose grosss income consists of gains, profits, commissions, or other income, derived from a Government contract or contracts made between April 6, 1917, and November 11, 1918, both dates inclusive. In such case the corporation so taken out shall be separately assessed on the basis of its own invested capital and net income and the remainder of such affiliated group shall be assessed on the basis of the remaining consolidated invested capital and net income.

In any case in which a tax is assessed upon the basis of a consolidated return, the total tax shall be computed in the first instance as a unit and shall then be assessed upon the respective affiliated corporations in such proportions as may be agreed upon among them, or, in the absence of any such agreement, then on the basis of the net income properly assignable to each. There shall be allowed in computing the income tax only one specific credit of $2,000 (as provided in section 236); in computing the war-profits credit (as provided in section 311) only one specific exemption of $3,000; and in computing the excess-profits credit (as provided in section 312) only one specific exemption of $3,000.

(b) For the purpose of this section two or more domestic corporations shall be deemed to be affiliated (1) if one corporation owns directly or controls through closely affiliated interests or by a nominee or nominees substantially all the stock of the other or others, or (2) if substantially all the stock of two or more corporations is owned or controlled by the same interests.

(c) For the purposes of section 238 a domestic corporation which owns a majority of the voting stock of a foreign corporation shall be deemed to have paid the same proportion of any income, war-profits, and excess-profits taxes paid (but not including taxes accrued) by such foreign corporation during the taxable year to any foreign country or to any possession of the United States upon income derived from sources without the United States, which the amount of any dividends (not deductible under section 234) received by such domestic corporation from such foreign corporation during the taxable year bears to the total taxable income of such foreign corporation upon or with respect to which such taxes were paid: *Provided,* That in no such case shall the amount of the credit for such taxes exceed the amount of such dividends (not deductible under section 234) received by such domestic corporation during the taxable year.

TIME AND PLACE FOR FILING RETURNS

SEC. 241.(a) That returns of corporations shall be made at the same time as is provided in subdivision (a) of section 227.

(b) Returns shall be made to the collector of the district in which is located the principal place of business or principal office or agency of the corporation, or, if it has no principal place of business or principal office or agency in the United States, then to the collector at Baltimore, Maryland.

PART IV.—ADMINISTRATIVE PROVISIONS

PAYMENT OF TAXES

SEC. 250.(a) That except as otherwise provided in this section and sections 221 and 237 the tax shall be paid in four installments, each consisting of one-fourth of the total amount of the tax. The first installment shall be paid at the time fixed by law for filing the return, and the second installment shall be paid on the fifteenth day of the third month, the third installment on the fifteenth day of the six month, and the fourth installment on the fifteenth day of the ninth month, after the time fixed by law for filing the return. Where an extension of time for filing a return is granted the time for payment of the first installment shall be postponed until the date of the expiration of the period of the extension, but the time for payment of the other installments shall not be postponed unless the Commissioner so provides in granting the extension. In any case in which the time for the payment of any installment is at the request of the taxpayer thus postponed, there shall be added as part of such installment interest thereon at the rate of ½ of 1 per centum per month from the time it would have been due if no extension had been granted, until paid. If any installment is not paid when due, the whole amount of the tax unpaid shall become due and payable upon notice and demand by the collector.

The tax may at the option of the taxpayer be paid in a single payment instead of in installments, in which case the total amount shall be paid on or before the time fixed by law for filing the return, or, where an extension of time for filing the return has been granted, on or before the expiration of the period of such extension.

(b) As soon as practicable after the return is filed, the Commissioner shall examine it. If it then appears that the correct amount of the tax is greater or less than that shown in the return, the installments shall be recomputed. If the amount already paid exceeds that which should have been paid on the basis of the installments as recomputed, the excess so paid shall be credited against the subsequent installments; and if the amount already paid exceeds the correct amount of the tax, the excess shall be credited or refunded to the taxpayer in accordance with the provisions of section 252.

If the amount already paid is less than that which should have been paid, the difference shall, to the extent not covered by any credits then due to the taxpayer under section 252, be paid upon notice and demand by the collector. In such case if the return is made in good faith and the understatement of the amount in the return is not due to any fault of the taxpayer, there shall be no penalty because of such understatement. If the understatement is due to negligence on the part of the taxpayer, but without intent to defraud, there shall be added as part of the tax 5 per centum of the total amount of the deficiency, plus interest at the rate of 1 per centum per month on the amount of the deficiency of each installment from the time the installment was due.

If the understatement is false or fraudulent with intent to evade the tax, then, in lieu of the penalty provided by section 3176 of the Revised Statutes, as amended, for false or fraudulent returns wilfully made, but in addition to other penalties provided by law for false or fraudulent

returns, there shall be added as part of the tax 50 per centum of the amount of the deficiency.

(c) If the return is made pursuant to section 3176 of the Revised Statutes as amended, the amount of tax determined to be due under such return shall be paid upon notice and demand by the collector.

(d) Except in the case of false or fraudulent returns with intent to evade the tax, the amount of tax due under any return shall be determined and assessed by the Commissioner within five years after the return was due or was made, and no suit or proceeding for the collection of any tax shall be begun after the expiration of five years after the date when the return was due or was made. In the case of such false or fraudulent returns, the amount of tax due may be determined at any time after the return is filed, and the tax may be collected at any time after it becomes due.

(e) If any tax remains unpaid after the date when it is due, and for ten days after notice and demand by the collector, then, except in the case of estates of insane, deceased, or insolvent persons, there shall be added as part of the tax the sum of 5 per centum on the amount due but unpaid, plus interest at the rate of 1 per centum per month upon such amount from the time it became due: *Provided*, That as to any such amount which is the subject of a bona fide claim for abatement such sum of 5 per centum shall not be added and the interest from the time the amount was due until the claim is decided shall be at the rate of ½ of 1 per centum per month.

In the case of the first installment provided for in subdivision (a) the instructions printed on the return shall be deemed sufficient notice of the date when the tax is due and sufficient demand, and the taxpayer's computation of the tax on the return shall be deemed sufficient notice of the amount due.

(f) In any case in which in order to enforce payment of a tax it is necessary for a collector to cause a warrant of distraint to be served, there shall also be added as part of the tax the sum of $5.

(g) If the Commissioner finds that a taxpayer designs quickly to depart from the United States or to remove his property therefrom, or to conceal himself or his property therein, or to do any other act tending to prejudice or to render wholly or partly ineffectual proceedings to collect the tax for the taxable year then last past or the taxable year then current unless such proceedings be brought without delay, the Commissioner shall declare the taxable period for such taxpayer terminated at the end of the calendar month then last past and shall cause notice of such finding and declaration to be given the taxpayer, together with a demand for immediate payment of the tax for the taxable period so declared terminated and of the tax for the preceding taxable year or so much of said tax as is unpaid, whether or not the time otherwise allowed by law for filing return and paying the tax has expired; and such taxes shall thereupon become immediately due and payable. In any action or suit brought to enforce payment of taxes made due and payable by virtue of the provisions of this subdivision the finding of the Commissioner, made as herein provided, whether made after notice to the taxpayer or not, shall be for all purposes presumptive evidence of the taxpayer's design. A taxpayer who is not in default in making

any return or paying income, war-profits, or excess-profits tax under any Act of Congress may furnish to the United States, under regulations to be prescribed by the Commissioner with the approval of the Secretary, security approved by the Commissioner that he will duly make the return next thereafter required to be filed and pay the tax next thereafter required to be paid. The Commissioner may approve and accept in like manner security for return and payment of taxes made due and payable by virtue of the provisions of this subdivision, provided the taxpayer has paid in full all other income, war-profits, or excess-profits taxes due from him under any Act of Congress. If security is approved and accepted pursuant to the provisions of this subdivision and such further or other security with respect to the tax or taxes covered thereby is given as the Commissioner shall from time to time find necessary and require, payment of such taxes shall not be enforced by any proceedings under the provisions of this subdivision prior to the expiration of the time otherwise allowed for paying such respective taxes.

RECEIPTS FOR TAXES

Sec. 251. That every collector to whom any payment of any tax is made under the provisions of this title shall upon request give to the person making such payment a full written or printed receipt, stating the amount paid and the particular account for which such payment was made; and whenever any debtor pays taxes on account of payments made or to be made by him to separate creditors the collector shall, if requested by such debtor, give a separate receipt for the tax paid on account of each creditor in such form that the debtor can conveniently produce such receipts separately to his several creditors in satisfaction of their respective demands up to the amounts stated in the receipts; and such receipts shall be sufficient evidence in favor of such debtor to justify him in withholding from his next payment to his creditor the amount therein stated; but the creditor may, upon giving to his debtor a full written receipt acknowledging the payment to him of any sum actually paid and accepting the amount of tax paid as aforesaid (specifying the same) as a further satisfaction of the debt to that amount, require the surrender to him of such collector's receipt.

REFUNDS

Sec. 252. That if, upon examination of any return of income made pursuant to this Act, the Act of August 5, 1909, entitled "An Act to provide revenue, equalize duties, and encourage the industries of the United States, and for other purposes," the Act of October 3, 1913, entitled "An Act to reduce tariff duties and to provide revenue for the Government, and for other purposes," the Revenue Act of 1916, as amended, or the Revenue Act of 1917, it appears that an amount of income, war-profits or excess-profits tax has been paid in excess of that properly due, then, notwithstanding the provisions of section 3228 of the Revised Statutes, the amount of the excess shall be credited against any income, war-profits or excess-profits taxes, or installment thereof, then due from the taxpayer under any other return, and any balance of such excess shall be immediately refunded to the taxpayer:

Provided, That no such credit or refund shall be allowed or made after five years from the date when the return was due, unless before the expiration of such five years a claim therefor is filed by the taxpayer.

PENALTIES

SEC. 253. That any individual, corporation, or partnership required under this title to pay or collect any tax, to make a return or to supply information, who fails to pay or collect such tax, to make such return, or to supply such information at the time or times required under this title, shall be liable to a penalty of not more than $1,000. Any individual, corporation, or partnership, or any officer or employee or any corpoation or member or employee of a partnership, who willfully refuses to pay or collect such tax, to make such return, or to supply such information at the time or times required under this title, or who willfully attempts in any manner to defeat or evade the tax imposed by this title, shall be guilty of a misdemeanor and shall be fined not more than $10,000 or imprisoned for not more than one year, or both, together with the costs of prosecution.

RETURNS OF PAYMENTS OF DIVIDENDS

SEC. 254. That every corporation subject to the tax imposed by this title and every personal service corporation shall, when required by the Commissioner, render a correct return duly verified under oath, of its payments of dividends, stating the name and address of each stockholder, the number of shares owned by him, and the amount of dividends paid to him.

RETURNS OF BROKERS

SEC. 255. That every individual, corporation, or partnership doing business as a broker shall, when required by the Commissioner, render a correct return duly verified under oath, under such rules and regulations as the Commissioner, with the approval of the Secretary, may prescribe, showing the names of customers for whom such individual, corporation, or partnership has transacted any business, with such details as to the profits, losses, or other information which the Commissioner may require, as to each of such customers, as will enable the Commissioner to determine whether all income tax due on profits or gains of such customers has been paid.

INFORMATION AT SOURCE

SEC. 256. That all individuals, corporations, and partnerships, in whatever capacity acting, including lessees or mortgagors of real or personal property, fiduciaries, and employers, making payment to another individual, corporation, or partnership, of interest, rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable gains, profits, and income (other than payments described in sections 254 and 255), of $1,000 or more in any taxable year, or, in the case of such payments made by the United States, the officers or employees of the United States having information as to such payments and required to make returns in regard thereto by the regulations hereinafter provided for, shall render a true and accurate return to the Commissioner, under such regulations and in

such form and manner and to such extent as may be prescribed by him with the approval of the Secretary, setting forth the amount of such gains, profits, and income, and the name and address of the recipient of such payment.

Such returns may be required, regardless of amounts, (1) in the case of payments of interest upon bonds, mortgages, deeds of trust, or other similar obligations of corporations, and (2) in the case of collections of items (not payable in the United States) of interest upon the bonds of foreign countries and interest upon the bonds of and dividends from foreign corporations by individuals, corporations, or partnerships, undertaking as a matter of business or for profit the collection of foreign payments of such interest or dividends by means of coupons, checks, or bills of exchange.

When necessary to make effective the provisions of this section the name and address of the recipient of income shall be furnished upon demand of the individual, corporation, or partnership paying the income.

The provisions of this section shall apply to the calendar year 1918 and each calendar year thereafter, but shall not apply to the payment of interest on obligations of the United States.

RETURNS TO BE PUBLIC RECORDS

SEC. 257. That returns upon which the tax has been determined by the Commissioner shall constitute public records; but they shall be open to inspection only upon order of the President and under rules and regulations prescribed by the Secretary and approved by the President: *Provided*, That the proper officers of any State imposing an income tax may, upon the request of the governor thereof, have access to the returns of any corporation, or to an abstract thereof showing the name and income of the corporation, at such times and in such manner as the Secretary may prescribe: *Provided further*, That all bona fide stockholders of record owning 1 per centum or more of the outstanding stock of any corporation shall, upon making request of the Commissioner, be allowed to examine the annual income returns of such corporation and of its subsidiaries. Any stockholder who pursuant to the provisions of this section is allowed to examine the return of any corporation, and who makes known in any manner whatever not provided by law the amount or source of income, profits, losses, expenditures, or any particular thereof, set forth or disclosed in any such return, shall be guilty of a misdemeanor and be punished by a fine not exceeding $1,000, or by imprisonment not exceeding one year, or both.

The Commissioner shall as soon as practicable in each year cause to be prepared and made available to public inspection in such manner as he may determine, in the office of the collector in each internal-revenue district and in such other places as he may determine, lists containing the names and the post-office addresses of all individuals making income-tax returns in such district.

PUBLICATION OF STATISTICS

SEC. 258. That the Commissioner, with the approval of the Secretary, shall prepare and publish annually statistics reasonably available with respect to the operation of the income, war-profits and excess-profits tax

laws, including classifications of taxpayers and of income, the amounts allowed as deductions, exemptions, and credits, and any other facts deemed pertinent and valuable.

COLLECTION OF FOREIGN ITEMS

SEC. 259. That all individuals, corporations, or partnerships undertaking as a matter of business or for profit the collections of foreign payments of interest or dividends by means of coupons, checks, or bills of exchange shall obtain a license from the Commissioner and shall be subject to such regulations enabling the Government to obtain the information required under this title as the Commissioner, with the approval of the Secretary, shall prescribe; and whoever knowingly undertakes to collect such payments without having obtained a license therefor, or without complying with such regulations, shall be guilty of a misdemeanor and shall be fined not more than $5,000, or imprisoned for not more than one year or both.

CITIZENS OF UNITED STATES POSSESSIONS

SEC. 260. That any individual who is a citizen of any possession of the United States (but not otherwise a citizen of the United States) and who is not a resident of the United States, shall be subject to taxation under this title only as to income derived from sources within the United States, and in such case the tax shall be computed and paid in the same manner and subject to the same conditions as in the case of other persons who are taxable only as to income derived from such sources.

PORTO RICO AND PHILIPPINE ISLANDS

SEC. 261. That in Porto Rico and the Philippine Islands the income tax shall be levied, assessed, collected, and paid in accordance with the provisions of the Revenue Act of 1916 as amended.

Returns shall be made and taxes shall be paid under Title I of such Act in Porto Rico or the Philippine Islands, as the case may be, by (1) every individual who is a citizen or resident of Porto Rico or the Philippine Islands or derives income from sources therein, and (2) every corporation created or organized in Porto Rico or the Philippine Islands or deriving income from sources therein. An individual who is neither a citizen nor a resident of Porto Rico or the Philippine Islands but derives income from sources therin, shall be taxed in Porto Rico or the Philippine Islands as a nonresident alien individual, and a corporation created or organized outside Porto Rico or the Philippine Islands and deriving income from sources therein shall be taxed in Porto Rico or the Philippine Islands as a foreign corporation. For the purposes of section 216 and of paragraph (6) of subdivision (a) of section 234 a tax imposed in Porto Rico or the Philippine Islands upon the net income of a corporation shall not be deemed to be a tax under this title.

The Porto Rican or Philippine Legislature shall have power by due enactment to amend, alter, modify, or repeal the income tax laws in force in Porto Rico or the Philippine Islands, respectively.

TITLE III.—WAR-PROFITS AND EXCESS-PROFITS TAX

PART I.—GENERAL DEFINITIONS

SEC. 300. That when used in this title the terms "taxable year,' "fiscal year," "personal service corporation," "paid or accrued," and "dividends" shall have the same meaning as provided for the purposes of income tax in sections 200 and 201. The first taxable year for the purposes of this title shall be the same as the first taxable year for the purposes of the income tax under Title II.

PART II.—IMPOSITION OF TAX

SEC. 301.(a) That in lieu of the tax imposed by Title II of the Revenue Act of 1917, but in addition to the other taxes imposed by this Act, there shall be levied, collected, and paid for the taxable year 1918 upon the net income of every corporation a tax equal to the sum of the following:

FIRST BRACKET

30 per centum of the amount of the net income in excess of the excess-profits credit (determined under section 312) and not in excess of 20 per centum of the invested capital;

SECOND BRACKET

65 per centum of the amount of the net income in excess of 20 per centum of the invested capital;

THIRD BRACKET

The sum, if any, by which 80 per centum of the amount of the net income in excess of the war-profits credit (determined under section 311) exceeds the amount of the tax computed under the first and second brackets.

(b) For the taxable year 1919 and each taxable year thereafter there shall be levied, collected, and paid upon the net income of every corporation (except corporations taxable under subdivision (c) of this section) a tax equal to the sum of the following:

FIRST BRACKET

20 per centum of the amount of the net income in excess of the excess-profits credit (determined under section 312) and not in excess of 20 per centum of the invested capital;

SECOND BRACKET

40 per centum of the amount of the net income in excess of 20 per centum of the invested capital.

(c) For the taxable year 1919 and each taxable year thereafter there shall be levied, collected, and paid upon the net income of every corporation which derives in such year a net income of more than $10,000 from any Government contract or contracts made between April 6, 1917, and November 11, 1918, both dates inclusive, a tax equal to the sum of the following:

(1) Such a portion of a tax computed at the rate specified in subdivision (a) as the part of the net income attributable to such Government contract or contracts bears to the entire net income. In computing such tax the excess-profits credit and the war-profits credit applicable to the taxable year shall be used;

(2) Such a portion of a tax computed at the rate specified in subdivision (b) as the part of the net income not attributable to such Government contract or contracts bears to the entire net income.

For the purpose of determining the part of the net income attributable to such Government contract or contracts, the proper apportionment and allocation of the deductions with respect to gross income derived from such Government contract or contracts and from other sources, respectively, shall be determined under rules and regulations prescribed by the Commissioner with the approval of the Secretary.

(d) In any case where the full amount of the excess-profits credit is not allowed under the first bracket of subdivision (a) or (b), by reason of the fact that such credit is in excess of 20 per centum of the invested capital, the part not so allowed shall be deducted from the amount in the second bracket.

(e) For the purposes of the Act approved March 21, 1918, entitled "An Act to provide for the operation of transportation systems while under Federal control, for the just compensation of their owners, and for other purposes," the tax imposed by this title shall be treated as levied by an Act in amendment of Title II of the Revenue Act of 1917.

Sec. 302. That the tax imposed by subdivision (a) of section 301 shall in no case be more than 30 per centum of the amount of the net income in excess of $3,000 and not in excess of $20,000, plus 80 per centum of the amount of the net income in excess of $20,000; the tax imposed by subdivision (b) of section 301 shall in no case be more than 20 per centum of the amount of the net income in excess of $3,000 and not in excess of $20,000, plus 40 per centum of the amount of the net income in excess of $20,000; and the above limitations shall apply to the taxes computed under subdivisions (a) and (b) of section 301, respectively, when used in subdivision (c) of that section. Nothing in this section shall be construed in such manner as to increase the tax imposed by section 301.

Sec. 303. That if part of the net income of a corporation is derived (1) from a trade or business (or a branch of a trade or business) in which the employment of capital is necessary, and (2) a part (constituting not less than 30 per centum of its total net income) is derived from a separate trade or business (or a distinctly separate branch of the trade or business) which if constituting the sole trade or business would bring it within the class of "personal service corporations," then (under regulations prescribed by the Commissioner with the approval of the Secretary) the tax upon the first part of such net income shall be separately computed (allowing in such computation only the same proportionate part of the credits authorized in sections 311 and 312), and the tax upon the second part shall be the same percentage thereof as the tax so computed upon the first part is of such first part: *Provided*, That the tax upon such second part shall in no case be less than 20 per centum thereof, unless the tax upon the entire net income, if computed

without benefit of this section, would constitute less than 20 per centum of such entire net income, in which event the tax shall be determined upon the entire net income, without reference to this section, as other taxes are determined under this title. The total tax computed under this section shall be subject to the limitations provided in section 302.

SEC. 304.(a) That the corporations enumerated in section 231 shall, to the extent that they are exempt from income tax under Title II, be exempt from taxation under this title.

(b) Any corporation whose net income for the taxable year is less than $3,000 shall be exempt from taxation under this title.

(c) In the case of any corporation engaged in the mining of gold, the portion of the net income derived from the mining of gold shall be exempt from the tax imposed by this title, and the tax on the remaining portion of the net income shall be the proportion of a tax computed without the benefit of this subdivision which such remaining portion of the net income bears to the entire net income.

SEC. 305. That if a tax is computed under this title for a period of less than twelve months, the specific exemption of $3,000, wherever referred to in this title, shall be reduced to an amount which is the same proportion of $3,000 as the number of months in the period is of twelve months.

PART III.—CREDITS

SEC. 310. That as used in this title the term "prewar period" means the calendar years 1911, 1912, and 1913, or, if a corporation was not in existence during the whole of such period, then as many of such years during the whole of which the corporation was in existence.

SEC. 311.(a) That the war-profits credit shall consist of the sum of:

(1) A specific exemption of $3,000; and

(2) An amount equal to the average net income of the corporation for the prewar period, plus or minus, as the case may be, 10 per centum of the difference between the average invested capital for the prewar period and the invested capital for the taxable year. If the tax is computed for a period of less than twelve months such amount shall be reduced to the same proportion thereof as the number of months in the period is of twelve months.

(b) If the corporation had no net income for the prewar period, or if the amount computed under paragraph (2) of subdivision (a) is less than 10 per centum of its invested capital for the taxable year, then the war-profits credit shall be the sum of:

(1) A specific exemption of $3,000; and

(2) An amount equal to 10 per centum of the invested capital for the taxable year.

(c) If the corporation was not in existence during the whole of at least one calendar year during the prewar period, then, except as provided in subdivision (d), the war-profits credit shall be the sum of:

(1) A specific exemption of $3,000; and

(2) An amount equal to the same percentage of the invested capital of the taxpayer for the taxable year as the average percentage of net income to invested capital, for the prewar period, of corporations en-

gaged in a trade or business of the same general class as that conducted by the taxpayer; but such amount shall in no case be less than 10 per centum of the invested capital of the taxpayer for the taxable year. Such average percentage shall be determined by the Commissioner on the basis of data contained in returns made under Title II of the Revenue Act of 1917, and the average known as the median shall be used. If such average percentage has not been determined and published at least 30 days prior to the time when the return of the taxpayer is due, then for purposes of such return 10 per centum shall be used in lieu thereof; but such average percentage when determined shall be used for the purposes of section 250 in determining the correct amount of the tax.

(d) The war-profits credit shall be determined in the manner provided in subdivision (b) instead of in the manner provided in subdivision (c), in the case of any corporation which was not in existence during the whole of at least one calendar year during the prewar period, if (1) a majority of its stock at any time during the taxable year is owned or controlled, directly or indirectly, by a corporation which was in existence during the whole of at least one calendar year during the prewar period, or if (2) 50 per centum or more of its gross income (as computed under section 233 for income tax purposes) consists of gains, profits, commissions, or other income, derived from a Government contract or contracts made between April 6, 1917, and November 11, 1918, both dates inclusive.

(e) A foreign corporation shall not be entitled to a specific exemption of $3,000.

SEC. 312. That the excess-profits credit shall consist of a specific exemption of $3,000 plus an amount equal to 8 per centum of the invested capital for the taxable year.

A foreign corporation shall not be entitled to the specific exemption of $3,000.

PART IV.—NET INCOME

SEC. 320.(a) That for the purpose of this title the net income of a corporation shall be ascertained and returned—

(1) For the calendar years 1911 and 1912 upon the same basis and in the same manner as provided in section 38 of the Act entitled "An Act to provide revenue, equalize duties, and encourage the industries of the United States, and for other purposes," approved August 5, 1909, except that taxes imposed by such section and paid by the corporation within the year shall be included;

(2) For the calendar year 1913 upon the same basis and in the same manner as provided in Section II of the Act entitled "An Act to reduce tariff duties and to provide revenue for the Government, and for other purposes," approved October 3, 1913, except that taxes imposed by section 38 of such Act of August 5, 1909, and paid by the corporation within the year shall be included, and except that the amounts received by it as dividends upon the stock or from the net earnings of other corporations subject to the tax imposed by Section II of such Act of October 3, 1913, shall be deducted; and

(3) For the taxable year upon the same basis and in the same manner as provided for income tax purposes in Title II of this Act.

(b) The average net income for the prewar period shall be determined by dividing the number of years within that period during the whole of which the corporation was in existence into the sum of the net income for such years, even though there may have been no net income for one or more of such years.

PART V.—INVESTED CAPITAL

SEC. 325.(a) That as used in this title—

The term "intangible property" means patents, copyrights, secret processes and formulæ, good will, trade-marks, trade-brands, franchises, and other like property;

The term "tangible property" means stocks, bonds, notes, and other evidences of indebtedness, bills and accounts receivable, leaseholds, and other property other than intangible property;

The term "borrowed capital" means money or other property borrowed, whether represented by bonds, notes, open accounts, or otherwise;

The term "inadmissible assets" means stocks, bonds, and other obligations (other than obligations of the United States), the dividends or interest from which is not included in computing net income, but where the income derived from such assets consists in part of gain or profit derived from the sale or other disposition thereof, or where all or part of the interest derived from such assets is in effect included in the net income because of the limitation on the deduction of interest under paragraph (2) of subdivision (a) of section 234, a corresponding part of the capital invested in such assets shall not be deemed to be inadmissible assets;

The term "admissible assets" means all assets other than inadmissible assets, valued in accordance with the provisions of subdivision (a) of section 326, section 330, and section 331.

(b) For the purposes of this title, the par value of stock or shares shall, in the case of stock or shares issued at a nominal value or having no par value, be deemed to be the fair market value as of the date or dates of issue of such stock or shares.

SEC. 326.(a) That as used in this title the term "invested capital" for any year means (except as provided in subdivisions (b) and (c) of this section):

(1) Actual cash bona fide paid in for stock or shares;

(2) Actual cash value of tangible property, other than cash, bona fide paid in for stock or shares, at the time of such payment, but in no case to exceed the par value of the original stock or shares specifically issued therefor, unless the actual cash value of such tangible property at the time paid in is shown to the satisfaction of the Commissioner to have been clearly and substantially in excess of such par value, in which case such excess shall be treated as paid-in surplus: *Provided*, That the Commissioner shall keep a record of all cases in which tangible property is included in invested capital at a value in excess of the stock or shares issued therefor, containing the name and address of each taxpayer, the business in which engaged, the amount of invested capital and net income shown by the return, the value of the tangible property at the time paid in, the par value of the stock or shares specifically issued there-

for, and the amount included under this paragraph as paid-in surplus. The Commissioner shall furnish a copy of such record and other detailed information with respect to such cases when required by resolution of either House of Congress, without regard to the restrictions contained in section 257;

(3) Paid-in or earned surplus and undivided profits; not including surplus and undivided profits earned during the year;

(4) Intangible property bona fide paid in for stock or shares prior to March 3, 1917, in an amount not exceeding (a) the actual cash value of such property at the time paid in, (b) the par value of the stock or shares issued therefor, or (c) in the aggregate 25 per centum of the par value of the total stock or shares of the corporation outstanding on March 3, 1917, whichever is lowest;

(5) Intangible property bona fide paid in for stock or shares on or after March 3, 1917, in an amount not exceeding (a) the actual cash value of such property at the time paid in, (b) the par value of the stock or shares issued therefor, or (c) in the aggregate 25 per centum of the par value of the total stock or shares of the corporation outstanding at the beginning of the taxable year, whichever is lowest: *Provided*, That in no case shall the total amount included under paragraphs (4) and (5) exceed in the aggregate 25 per centum of the par value of the total stock or shares of the corporation outstanding at the beginning the of taxable year; but

(b) As used in this title the term "invested capital" does not include borrowed capital.

(c) There shall be deducted from invested capital as above defined a percentage thereof equal to the percentage which the amount of inadmissible assets is of the amount of admissible and inadmissible assets held during the taxable year.

(d) The invested capital for any period shall be the average invested capital for such period, but in the case of a corporation making a return for a fractional part of a year, it shall (except for the purpose of paragraph (2) of subdivision (a) of section 311) be the same fractional part of such average invested capital.

The average invested capital for the prewar period shall be determined by dividing the number of years within that period during the whole of which the corporation was in existence into the sum of the average invested capital for such years.

Sec. 327. That in the following cases the tax shall be determined as provided in section 328:

(a) Where the Commissioner is unable to determine the invested capital as provided in section 326;

(b) In the case of a foreign corporation;

(c) Where a mixed aggregate of tangible property and intangible property has been paid in for stock or for stock and bonds and the Commissioner is unable satisfactorily to determine the respective values of the several classes of property at the time of payment, or to distinguish the classes of property paid in for stock and for bonds, respectively;

(d) Where upon application by the corporation the Commissioner finds and so declares of record that the tax if determined without benefit of this section would, owing to abnormal conditions affecting the capital

or income of the corporation, work upon the corporation an exceptional hardship evidenced by gross disproportion between the tax computed without benefit of this section and the tax computed by reference to the representative corporations specified in section 328. This subdivision shall not apply to any case (1) in which the tax (computed without benefit of this section) is high merely because the corporation earned within the taxable year a high rate of profits upon a normal invested capital, nor (2)in which 50 per centum or more of the gross income of the corporation for the taxable year (computed under section 233 of Title II) consists of gains, profits, commissions, or other income, derived on a cost-plus basis from a Government contract or contracts made between April 6, 1917, and November 11, 1918, both dates inclusive.

SEC. 328.(a) In the cases specified in section 327 the tax shall be the amount which bears the same ratio to the net income of the taxpayer (in excess of the specific exemption of $3,000) for the taxable year, as the average tax of representative corporations engaged in a like or similar trade or business, bears to their average net income (in excess of the specific exemption of $3,000) for such year. In the case of a foreign corporation the tax shall be computed without deducting the specific exemption of $3,000 either for the taxpayer or the representative corporations.

In computing the tax under this section the Commissioner shall compare the taxpayer only with representative corporations whose invested capital can be satisfactorily determined under section 326 and which are, as nearly as may be, similiarly circumstanced with respect to gross income, net income, profits per unit of business transacted and capital employed, the amount and rate of war profits or excess profits, and all other relevant facts and circumstances.

(b) For the purposes of subdivision (a) the ratios between the average tax and the average net income of representative corporations shall be determined by the Commissioner in accordance with regulations prescribed by him with the approval of the Secretary.

In cases in which the tax is to be computed under this section, if the tax as computed without the benefit of this section is less than 50 per centum of the net income of the taxpayer, the installments shall in the first instance be computed upon the basis of such tax; but if the tax so computed is 50 per centum or more of the net income, the installments shall in the first instance be computed upon the basis of a tax equal to 50 per centum of the net income. In any case, the actual ratio when ascertained shall be used in determining the correct amount of the tax. If the correct amount of the tax when determined exceeds 50 per centum of the net income, any excess of the correct installments over the amounts actually paid shall on notice and demand be paid together with interest at the rate of ½ of 1 per centum per month on such excess from the time the installment was due.

(c) The Commissioner shall keep a record of all cases in which the tax is determined in the manner prescribed in subdivision (a), containing the name and address of each taxpayer, the business in which engaged, the amount of invested capital and net income shown by the return, and the amount of invested capital as determined under such subdivision. The Commissioner shall furnish a copy of such record and

other detailed information with respect to such cases when required by resolution of either House of Congress, without regard to the restrictions contained in section 257.

PART VI.—REORGANIZATIONS

SEC. 330. That in the case of the reorganization, consolidation, or change of ownership after January 1, 1911, of a trade or business now carried on by a corporation, the corporation shall for the purposes of this title be deemed to have been in existence prior to that date, and the net income and invested capital of such predecessor trade or business for all or any part of the prewar period prior to the organization of the corporation now carrying on such trade or business shall be deemed to have been the net income and invested capital of such corporation. If such predecessor trade or business was carried on by a partnership or individual the net income for the prewar period shall, under regulations prescribed by the Commissioner with the approval of the Secretary, be ascertained and returned as nearly as may be upon the same basis and in the same manner as provided for corporations in Title II, including a reasonable deduction for salary or compensation to each partner or the individual for personal services actually rendered.

In the case of the organization as a corporation before July 1, 1919, of any trade or business in which capital is a material income-producing factor and which was previously owned by a partnership or individual, the net income of such trade or business from January 1, 1918, to the date of such reorganization may at the option of the individual or partnership be taxed as the net income of a corporation is taxed under Titles II and III; in which event the net income and invested capital of such trade or business shall be computed as if such corporation had been in existence on and after January 1, 1918, and the undistributed profits or earnings of such trade or business shall not be subject to the surtax imposed in section 211, but amounts distributed on or after January 1, 1918, from the earnings of such trade or business shall be taxed to the recipients as dividends, and all the provisions of Titles II and III relating to corporations shall so far as practicable apply to such trade or business: *Provided,* That this paragraph shall not apply to any trade or business the net income of which for the taxable year 1918 was less than 20 per centum of its invested capital for such year: *Provided further,* That any taxpayer who takes advantage of this paragraph shall pay the tax imposed by section 1000 of this act and by the first subdivision of section 407 of the Revenue Act of 1916, as if such taxpayer had been a corporation on and after January 1, 1918, with a capital stock having no par value.

If any asset of the trade or business in existence both during the taxable year and any prewar year is included in the invested capital for the taxable year but is not included in the invested capital for such prewar year, or is valued on a different basis in computing the invested capital for the taxable year and such prewar year, respectively, then under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary such readjustments shall be made as are necessary to place the computation of the invested capital for such prewar year on the basis employed in determining the invested capital for the taxable year.

SEC. 331. In the case of the reorganization, consolidation, or change of ownership of a trade or business, or change of ownership of property, after March 3, 1917, if an interest or control in such trade or business or property of 50 per centum or more remains in the same persons, or any of them, then no asset transferred or received from the previous owner shall, for the purpose of determining invested capital, be allowed a greater value than would have been allowed under this title in computing the invested capital of such previous owner if such asset had not been so transferred or received: *Provided*, That if such previous owner was not a corporation, then the value of any asset so transferred or received shall be taken at its cost of acquisition (at the date when acquired by such previous owner) with proper allowance for depreciation, impairment, betterment or development, but no addition to the original cost shall be made for any charge or expenditure deducted as expense or otherwise on or after March 1, 1913, in computing the net income of such previous owner for purposes of taxation.

PART VII.—MISCELLANEOUS

SEC. 335.(a) That if a corporation (other than a personal service corporation) makes return for a fiscal year beginning in 1917 and ending in 1918, the tax for the first taxable year under this title shall be the sum of:

(1) The same proportion of a tax for the entire period computed under Title II of the Revenue Act of 1917 which the portion of such period falling within the calendar year 1917 is of the entire period, and (2) the same proportion of a tax for the entire period computed under this title at the rate specified in subdivision (a) of section 301 which the portion of such period falling within the calendar year 1918 is of the entire period. Any amount heretofore or hereafter paid on account of the tax imposed for such fiscal year by Title II of the Revenue Act of 1917 shall be credited toward the payment of the tax imposed for such fiscal year by this title, and if the amount so paid exceeds the amount of the tax imposed by this title, the excess shall be credited or refunded to the corporation in accordance with the provisions of section 252.

(b) If a corporation makes return for a fiscal year beginning in 1918 and ending in 1919, the tax for such fiscal year under this title shall be the sum of: (1) the same proportion of a tax for the entire period computed under subdivision (a) of section 301 which the portion of such period falling within the calendar year 1918 is of the entire period, and (2) the same proportion of a tax for the entire period computed under subdivision (b) or (c) of section 301 which the portion of such period falling within the calendar year 1919 is of the entire period.

(c) If a partnership or a personal service corporation makes return for a fiscal year beginning in 1917 and ending in 1918, it shall pay the same proportion of a tax for the entire period computed under Title II of the Revenue Act of 1917 which the portion of such period falling within the calendar year 1917 is of the entire period.

Any tax paid by a partnership or personal service corporation for any period beginning on or after January 1, 1918, shall be immediately

refunded to the partnership or corporation as a tax erroneously or illegally collected.

Sec. 336. That every corporation, not exempt under section 304, shall make a return for the purposes of this title. Such returns shall be made, and the taxes imposed by this title shall be paid, at the same times and places, in the same manner, and subject to the same conditions, as is provided in the case of returns and payment of income tax by corporations for the purposes of Title II, and all the provisions of that title not inapplicable, including penalties, are hereby made applicable to the taxes imposed by this title.

Sec. 337. That in the case of a bona fide sale of mines, oil or gas wells, or any interest therein, where the principal value of the property has been demonstrated by prospecting or exploration and discovery work done by the taxpayer, the portion of the tax imposed by this title attributable to such sale shall not exceed 20 per centum of the selling price of such property or interest.

GENERAL AND ADMINISTRATIVE PROVISIONS

Sec. 1305. That all administrative, special, or stamp provisions of law, including the law relating to the assessment of taxes, so far as applicable, are hereby extended to and made a part of this Act, and every person liable to any tax imposed by this Act, or for the collection thereof, shall keep such records and render, under oath, such statements and returns, and shall comply with such regulations as the Commissioner, with the approval of the Secretary, may from time to time prescribe.

Whenever in the judgment of the Commissioner necessary he may require any person, by notice served upon him, to make a return or such statements as he deems sufficient to show whether or not such person is liable to tax.

The Commissioner, for the purpose of ascertaining the correctness of any return or for the purpose of making a return where none has been made, is hereby authorized, by any revenue agent or inspector designated by him for that purpose, to examine any books, papers, records or memoranda bearing upon the matters required to be included in the return, and may require the attendance of the person rendering the return or of any officer or employee of such person, or the attendance of any other person having knowledge in the premises, and may take his testimony with reference to the matter required by law to be included in such return, with power to administer oaths to such person or persons.

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Sec. 1309. That the Commissioner, with the approval of the Secretary, is hereby authorized to make all needful rules and regulations for the enforcement of the provisions of this Act.

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Sec. 1313. That in the payment of any tax under this Act not payable by stamp a fractional part of a cent shall be disregarded unless it

amounts to one-half cent or more in which case it shall be increased to 1 cent.

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Sec. 1314. That collectors may receive, at par with an adjustment for accrued interest, certificates of indebtedness issued by the United States and uncertified checks in payment of income, war-profits and excess-profits taxes and any other taxes payable other than by stamp, during such time and under such regulations as the Commissioner with the approval of the Secretary, shall prescribe; but if a check so received is not paid by the bank on which it is drawn the person by whom such check has been tendered shall remain liable for the payment of the tax and for all legal penalties and additions the same as if such check had not been tendered.

* * * * *

Sec. 1318. That if any person is summoned under this Act to appear, to testify, or to produce books, papers or other data, the district court of the United States for the district in which such person resides shall have jurisdiction by appropriate process to compel such attendance, testimony, or production of books, papers, or other data.

The district courts of the United States at the instance of the United States are hereby invested with such jurisdiction to make and issue, both in actions at law and suits in equity, writs and orders of injunction, and of ne exeat republica, orders appointing receivers, and such other orders and process, and to render such judgments and decrees, granting in proper cases both legal and equitable relief together, as may be necessary or appropriate for the enforcement of the provisions of this Act. The remedies hereby provided are in addition to and not exclusive of any and all other remedies of the United States in such courts or otherwise to enforce such provisions.

* * * * *

Sec. 1320. That wherever by the laws of the United States or regulations made pursuant thereto, any person is required to furnish any recognizance, stipulation, bond, guaranty, or undertaking, hereinafter called "penal bond," with surety or sureties, such person may, in lieu of such surety or sureties, deposit as security with the official having authority to approve such penal bond, United States Liberty bonds or other bonds of the United States in a sum equal at their par value to the amount of such penal bond required to be furnished, together with an agreement authorizing such official to collect or sell such bonds so deposited in case of any default in the performance of any of the conditions or stipulations of such penal bond. The acceptance of such United States bonds in lieu of surety or sureties required by law shall have the same force and effect as individual or corporate sureties, or certified checks, bank drafts, post-office money orders, or cash, for the penalty or amount of such penal bond. The bonds deposited hereunder, and such other United States bonds as may be substituted therefor from time to time as such security, may be deposited with the Treasurer, or an Assistant Treasurer of the United States, a Government depository, Federal Reserve bank, or member bank, which shall issue receipt therefor, describing such bonds so deposited. As soon as security for the performance of such penal bond is no longer necessary,

such bonds so deposited shall be returned to the depositor: *Provided*. That in case a person or persons supplying a contractor with labor or material as provided by the Act of Congress, approved February 24, 1905 (33 Stat., 811), entitled "An Act to amend an Act approved August thirteenth, eighteen hundred and ninety-four, entitled 'An Act for the protection of persons furnishing materials and labor for the construction of public works'," shall file with the obligee, at any time after a default in the performance of any contract subject to said Acts, the application and affidavit therein provided, the obligee shall not deliver to the obligor the deposited bonds nor any surplus proceeds thereof until the expiration of the time limited by said Acts for the institution of suit by such person or persons, and, in case suit shall be instituted within such time, shall hold said bonds or proceeds subject to the order of the court having jurisdiction thereof: *Provided further*, That nothing herein contained shall affect or impair the priority of the claim of the United States against the bonds deposited or any right or remedy granted by said Acts or by this section to the United States for default upon any obligation of said penal bond: *Provided further*, That all laws inconsistent with this section are hereby so modified as to conform to the provisions hereof: *And provided further*, That nothing contained herein shall affect the authority of courts over the security, where such bonds are taken as security in judicial proceedings, or the authority of any administrative officer of the United States to receive United States bonds for security in cases authorized by existing laws. The Secretary may prescribe rules and regulations necessary and proper for carrying this section into effect.

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SEC. 1400. (a) That the following parts of Acts are hereby repealed, subject to the limitations provided in subdivision (b):

(1) The following titles of the Revenue Act of 1916:

Title I (called "Income Tax");

Title II (called "Estate Tax");

Title III (called "Munitions Manufacturers' Tax"), as amended;

Title IV (called "Miscellaneous Taxes").

(2) The following parts of the Act entitled "An Act to provide increased revenue to defray the expenses of the increased appropriations for the Army and Navy and the extensions of fortifications, and for other purposes," approved March 3, 1917:

Title III (called "Estate Tax");

Section 402 (called "Returns of Dividends").

(3) The following titles of the Revenue Act of 1917:

Title I (called "War Income Tax");

Title II (called "War Excess-Profits Tax");

Title III (called "War Tax on Beverages");

Title IV (called "War Tax on Cigars, Tobacco, and Manufacturers Thereof");

Title V (called "War Tax on Facilities Furnished by Public Utilities, and Insurance");

Title VI (called "War Excise Taxes");

Title VII (called "War Tax on Admissions and Dues");

Title VIII (called "War Stamp Taxes");

Title IX (called "War Estate Tax");
Title X (called "Administrative Provisions");
Title XII (called "Income-Tax Amendments").

(b) Such parts of Acts shall remain in force for the assessment and collection of all taxes which have accrued thereunder, and for the imposition and collection of all penalties or forfeitures which have accrued and may accrue in relation to any such taxes, and except that the unexpended balance of any appropriation heretofore made and now available for the administration of any such part of an Act shall be available for the administration of this Act or the corresponding provisions thereof: *Provided,* That, except as otherwise provided in this Act, no taxes shall be collected under Title I of the Revenue Act of 1916 as amended by the Revenue Act of 1917, or Title I or II of the Revenue Act of 1917, in respect to any period after December 31, 1917: *Provided further,* That the assessment and collection of all estate taxes, and the imposition and collection of all penalties or forfeitures, which have accrued under Title II of the Revenue Act of 1916 as amended by the Act entitled "An Act to provide increased revenue to defray the expenses of the increased appropriations for the Army and Navy and the extensions of fortifications, and for other purposes," approved March 3, 1917, or Title IX of the Revenue Act of 1917, shall be according to the provisions of Title IV of this Act. In the case of any tax imposed by any part of an Act herein repealed, if there is a tax imposed by this Act in lieu thereof, the provision imposing such tax shall remain in force until the corresponding tax under this Act takes effect under the provisions of this Act.

Title I of the Revenue Act of 1916 as amended by the Revenue Act of 1917 shall remain in force for the assessment and collection of the income tax in Porto Rico and the Philippine Islands, except as may be otherwise provided by their respective legislatures.

* * * * *

SEC. 1402. That if any clause, sentence, paragraph, or part of this Act shall for any reason be adjudged by any court of competent jurisdiction to be invalid, such judgment shall not affect, impair, or invalidate the remainder of this Act, but shall be confined in its operation to the clause, sentence, paragraph, or part thereof directly involved in the controversy in which such judgment has been rendered.

* * * * *

SEC. 1408. That every person who on or after April 6, 1917, has entered into any contract, undertaking, or agreement with the United States, or with any department, bureau, officer, commission, board, or agency under the United States or acting in his behalf, or with any other person having contract relations with the United States, for the performance of any work or the supplying of any materials or property for the use of or for the account of the United States, shall, within thirty days after a request of the Commissioner therefor, file with the Commissioner a true and correct copy of every such contract, undertaking, or agreement.

Whoever fails to comply with such request of the Commissioner

shall be guilty of a misdemeanor and shall be punished by a fine of not more than $1,000, or by imprisonment for not more than one year, or both.

The Commissioner shall (when not violative of the technical military or naval secrets of the Government) have access to all information and data relating to any such contract, undertaking, or agreement, in the possession, control or custody of any department, bureau, board, agency, officer or commission of the United States and may call upon any such department, bureau, board, agency, officer or commission for a full statement and description of any allowance for amortization, obsolescence, depreciation or loss, or of any valuation, appraisal, adjustment or final settlement, made in pursuance of any such contract, undertaking, or agreement.

SEC. 1409. That unless otherwise herein specially provided, this Act shall take effect on the day following its passage.

Approved, February 24, 1919.

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